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**A Critical Evaluation of the Analysis of Horizontal
Mergers under the Anti-Monopoly Law in China—
What Can we Learn From the EU?**

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Submitted in Fulfilment of the Requirements for the Degree of PhD in
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Abstract

This thesis is concerned with the problems met by the antitrust authority of the Antimonopoly Law (the AML 2008) of the People's Republic of China (PRC) during its merger control assessment. It provides solutions to some of these problems with reference to EU competition law. Although the thesis cannot solve all the problems once for all, it does provide effective solutions to the two following important issues: Firstly, how to make the horizontal merger analysis in China better predicts the effects of merger on the competitive process? Secondly, how to improve the public transparency of antitrust merger assessment in China?

Chinese Antimonopoly Law's horizontal merger assessment is still immature and experiencing further challenges for development. In order to establish a more appropriate and transparent merger control regime, the thesis chooses EU competition law to compare. Not only because it is more advanced, but also, because the AML 2008 is heavily influenced by the regime. However, it is noteworthy that the experience from EU cannot solve all problems met by Chinese antitrust authority; especially those are caused by Chinese political and economic structure which EU did not have. Nevertheless, by solving the problems met in the above two aspects, the thesis has contributed to a more effective and transparent horizontal merger control regime for Chinese Antimonopoly Law. Translations of titles, authors, and publishers from Chinese works are unofficial, and the laws in this thesis are up to date at 30 June 2013.

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Author's Declaration

I declare that, except where explicit reference is made to the contribution of others, this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature _____

Printed Name _____

List of Abbreviations

AML 2008: Chinese Antimonopoly Law;

ARL: The Administrative Reconsideration Law of the People's Republic of China

APL : Chinese Administrative Procedural Law;

DG Comp.: Directorate General for Competition;

EU: European Union;

GC: General Court;

HHI: Herfindahl-Hirschman Index;

SSNIP Test: Small but Significant Non-transitory Increase in Price Test;

HO: Hearing Officer;

MOFCOM: Ministry of Commerce of China;

SO: Statement of Objection;

ABA: American Bar Association;

A Critical Evaluation of the Analysis of Horizontal Mergers under the Anti-Monopoly Law in China— What Can we Learn From the EU?

Chapter 1 Introduction

1 Research Questions

This thesis examines antitrust merger analysis in the People's Republic of China.¹ Two questions are addressed. Firstly, comparing the EU and China, in which jurisdiction the horizontal merger analysis better predicts the effects of merger on the competitive process. If the EU has more advantages, what can China learn in order to improve its method of merger analysis? Secondly, which jurisdiction shows greater public transparency of merger assessment? If the EU, what can China learn in order to improve such transparency? The following are reasons for choosing these two research questions.

1.1 Aims of Antitrust Merger Control in China

Merger control can take various forms. In general terms a basic distinction is to be drawn between forms of control that are concerned essentially with the processes by which mergers and take-overs occur and those forms that are concerned with the significance of merger itself.² In China the former form of merger control is set out in its Company Law.³ It is formulated to regulate the organisation and

¹ The People's Republic of China (PRC), established in 1949, commonly known as China, has control over mainland China and the largely self-governing territories of Hong Kong (since 1997) and Macau (since 1999). China in the thesis only means the mainland China.

² M Dabbah and P Lasok QC, *Merger control worldwide*, (Cambridge University Press, 2005), 1.

³ See Chapter 9 in the Company Law of China which was promulgated by the Standing Committee of the National People's Congress on December 29, 1993. The law was revised three times on 25th December 1999, 28th August 2004 and 27th October 2005. An unofficial English translation of revision 2005 is available at: http://www.chinadaily.com.cn/bizchina/2006-04/17/content_569258_15.htm (Viewed on 1st October 2013). There was no official English translation available at the time of writing in thesis.

behaviour of companies, protecting the legitimate rights and interests of companies, shareholders and creditors.⁴ This is excluded from study in this thesis. In this thesis, merger control only concerns the effect of merger itself. In China this form of merger control is set out in Chapter 4 of the Anti-Monopoly Law (hereafter 'AML2008'). Under the AML 2008, merger control aims to prevent and restrain monopolistic conduct, protect fair competition, enhance economic efficiency, safeguard the interests of consumers and social public interest and promote the healthy development of the socialist market economy.⁵

Compared with the ultimate aim in the EU which is to protect consumer welfare, the purpose in China is conflicting. It is threefold. The first aim is protecting consumer welfare. Chinese law, however, does not explicitly confine its assessment to the consumer interest exclusively. Competitors' interests related to a concentration are also considered. As reported by the press, the Ministry of Commerce of the People's Republic of China (MOFCOM) may adopt complaints from domestic companies who claimed that their enterprises would not be able to survive if a particular merger were allowed to go through.⁶ Thirdly, there are some public interests quite independent of competition, such as establishing national monopolists⁷ or environmental legislation.⁸ MOFCOM does not provide a hierarchy

⁴ See Article 1, Anti-monopoly Law of the People's Republic of China (hereinafter [AML 2008](#)). The law was adopted at the 29th meeting of the Standing Committee of the 10th National People's Congress of the People's Republic of China on 30th August 2007 and entered into force since 1st August 2008. An unofficial English translation about the legislation is available in appendix. There is no official English translation during thesis study.

⁵ Article 1, the AML 2008. The AML 2008 did not define any specific purpose of merger control. Therefore the aim of merger control should be consistent with the general purpose of the AML 2008.

⁶ In *Coca Cola/Huiyuan*, the MOFCOM concerned the merger would reduce the business opportunities for domestic middle and small enterprises producing fruit juice, and restrain domestic enterprises in their participation in competition and innovation. In light of this, merger would adversely affect the structure of the relevant market and its effective competition, and also harm the healthy development of the relevant market in China. Announcement MOFCOM [2009] No.22, *Coca cola/Huiyuan*, point 3 in section 4, In *Inbev/AB*, the MOFCOM cleared the transaction on the condition that the merged entity should not seek to hold or increase equity interests in the other four domestic enterprises. See Announcement of MOFCOM [2008] No.95, *Inbev / Anheuser-Busch*.

⁷ The Chinese government has a mission to encourage and support the concentration between domestic enterprises. In the state's 'Tenth Five Planning', governments are required to promote the establishment of a series of giant enterprises and enterprise groups with well-known trademarks, independent Intellectual Property and extinguish technology. In 2001 six departments under the State Council issued a 'Guidance on the Development of Internationally Competitive Enterprise Groups' which states that according to the State's 'Tenth Five Planning', governments should give priority to developing a series of enterprise groups with the advantage of capital and technology to make them leading powers and improve the whole industry and structure in the market. In 2004 eight

or balancing mechanism for these competing goals. Thus it is hard to get a final decision if consumer welfare is increased, whereas the other two points are reduced by a concentration or vice versa.⁹

In this thesis, merger assessment focuses only on one definite goal of antitrust merger control in China, namely consumer welfare.

1.2 The Effects of Mergers on Consumer Welfare

An historical view has been that there is one-way causation from the structure of the market (the number of producers active in the market, barriers to entry, cost structures, product differentiation, etc.) to the conduct of producers in that market (in terms of pricing and output decision, advertising and product differentiation, research and development, collusion etc.) to consumer welfare (price of goods or service, the quality of the goods, consumer choice and

departments under the State Council including the enforcement authority of merger control, proposed again to 'promote the establishment of 15 to 20 large circulation enterprises in 5 to 8 years' in the 'Opinions on the Promotion of Establishment of Large Enterprises or Groups in the Area of Physical Distribution'. Faced with the promotion by the government, antitrust merger control might be swayed or compromised in the name of increasing public interest or the efficiency of merging parties.

⁸ 'Public interest' has not been clarified in related antitrust legislation. Scholars in China take Article 22 of the Interim Regulation on Mergers and Acquisition of Domestic Enterprises by Foreign Investors in 2006 (hereafter the 'Foreign M&A Regulations 2006') as explanation on its notion. The article provides that the public interest includes: technical and economic progress, acquisition of failing firms, an enterprise's international competitiveness, and environmental factors. The Interim Regulation on Mergers and Acquisition of Domestic Enterprises by Foreign Investors was promulgated by the MOFCOM on 2nd January 2003 and took into effect on the 12th April 2003. The amendment of 2006 (hereafter the 'Foreign M&A Regulations 2006') was issued on 8 August 2006 and took effect on the 8th September 2006. It changed from 'interim provision' to 'The Provisions for the Acquisition of Domestic Enterprises by Foreign Investors' on 22nd June 2009. This thesis discusses amendment 2006, an unofficial English translation is available at: http://www.chinadaily.com.cn/bizchina/2006-04/17/content_569271.htm (Viewed on the 24th September 2010). To date, no mention of 'public interest' has appeared in any published merger decisions.

⁹ The consequences of a horizontal merger are various. After merger the relevant market has one firm fewer than before. However, in most instances, merger will neither significantly impede competition in the relevant market nor impair consumer welfare. On the other hand, the cost saving resulting from the merger to society in general can outweigh the detrimental effect of the merger on consumer welfare. According to the consumer welfare standard, a merger should be prohibited if consumer welfare is impaired substantially. However, when considering the total welfare of society the merger should be cleared as welfare post-merger is increased. The goal of protecting consumers also easily conflicts with the goal of protecting the public interest. For example, consumer welfare is increased if greater choices are available. However, article 5 of the AML 2008 encourages transactions in order to 'expand the business scale'. In this case choices of products may be reduced for consumers. The conflicting goals of the AML 2008 are also discussed in, X Wang, Highlights of China's New Anti-monopoly Law, (2008) Volume 75, No. 1, *Antitrust Law Journal*, pp.142-144.

innovation of new products).¹⁰ Merger may change the structure of the market and result in conduct by producers in the market which may harm the interests of consumers.¹¹ Conducts can also influence the structure of the market. Competitors in a market can be eliminated through predatory pricing or tying, or by reducing or eliminating the scope for new entry by investing heavily in advertising, excess capacity or research and development. Consumer welfare may be affected because of the change in market structure. Therefore, merger should be investigated when the merged entity is predicted to harm consumer welfare through changing competitive process, namely changing market structure or adopting specific conducts.

In order to evaluate the appropriateness of horizontal merger control, criteria of Types I and II errors are introduced. Type I error is said to occur if a merger with significant anti-competitive effects is wrongly allowed ('false positive'), type II occurs if a merger is wrongly prohibited or cleared with restrictive conditions which would not impede market competition substantially ('false negative').¹²

1.3 Transparency of Merger Analysis

'Transparency' means the ability of the public to see and understand the workings of the merger review process. It requires fair and responsive explanation of the

¹⁰ The concept of consumer welfare has four components. Consumer welfare is enhanced if the price of goods or services is reduced; or the quality of those goods is increased while the price is not changed; or consumer choice is wider, or consumers benefit through technical innovation. The four components are recognised in paragraph 8 of the Commission Notice on the appraisal of horizontal merger under the Council Regulation on the control of concentrations between undertakings. In the foreword to the XXXIst Report on Competition Policy, 2001, Marios Monti, the then Commissioner for Competition Policy, stated: 'our objective is to ensure that competition is undistorted, so as to permit wider consumer choice, technological innovation and price competition'. Similarly, in *Procter & Gamble/VP Schickedanz (II)*, the Commission found that the proposed merger was likely to harm consumers in relation to price, quality, innovation and choice. See case IV/M.430 *Procter & Gamble/VP Schickedanz (II)* [1994]O.J.L354/32, paragraph 182,

¹¹ On this one-way causation see, W M Landes and R Posner, *Market Power in Antitrust Cases*, (1981) Volume 94 Number 5, *Harvard Law Review*, pp.937-996; For a sceptical view of the effects of antitrust policy on consumer welfare see R W Crandall and C Winston, *Does Antitrust Policy Improve Consumer Welfare? Assessing the Evidence*, (2003) Volume 17 Number 4, *Journal of Economic Perspectives*, pp.3-26. Effects of horizontal merger on market competition and the interest of consumers will be discussed in Chapter 3, 4 and 5.

¹² On Type I and Type II error refer to M.B. Shermer, *the Skeptic Encyclopaedia of Pseudoscience*, (ABC-CLIO, 2002), 455. See also L Roller and M Mano, *the Impact of the New Substantive Test in European Merger Control*, (2006) Volume 2 No.1, *European Competition Journal*, pp. 9-28.

anti-trust enforcers' action and inaction.¹³ Transparency of merger analysis enhances knowledge and compliance with the law and limits political interference and arbitrary activity in competition matters.¹⁴ Transparency of the reasons for a merger decision to the persons concerned also enables them to defend their rights and the Courts to exercise their supervisory jurisdiction.¹⁵ Although precise measurement of merger effect is rare¹⁶, authorities should aim to improve transparency to the public through legislation, guidelines and case decision.

1.4 Adoption of Merger Analysis in the EU as Reference

1.4.1 The Similarities between the EU and China

i. The same objectives of merger control between the EU and China

Both merger control in the EU and China protect competition in the market and consumer welfare.¹⁷ During the last decade there has been considerable discussion

¹³ R Pitofsky, Comments on Warren Grimes: Transparency in Federal Antitrust Enforcement, (2003) Volume 51, *Buffalo Law Review*, 995, available at: <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1341&context=facpub> (accessed on the 8th May 2012);

¹⁴ See C Ş Rusu, A Few Considerations regarding Transparency and Legal Certainty in European Merger Control, (2007) Issue 2, *Studia Universitatis Babeş-Bolyai Jurisprudentia*, pp.180-196; Business & Industry Advisory Committee to the OECD & International Chamber of Commerce, Recommended Framework for Best Practices in International Merger Control Procedures, (4th October 2001), available at: <http://www.biac.org/statements/comp/BIAC-ICCMergerPaper.pdf> (accessed on the 3rd March 2012); R Carlton *et al.*, Confidentiality and Disclosure in European Commission Antitrust Proceedings—the Case for Clarity, (2008) Volume 4, Number 2, *European Competition Journal*, pp.401-414.

¹⁵ Meaning of transparency in the EU can see in See Case T-199/99 *Sgaravatti Mediterranea Srl v Commission* [2002] E.C.R. II-2289, paragraph 100.

¹⁶ There may be two reasons for the rarity of precise measurement. Firstly, all merger control is to a greater or lesser extent forward-looking or prophylactic. The enforcement authority has to make predictions about the likely effect of the merger on competition in the market. Prediction may be speculative and uncertain. In addition, securing access to sufficient data to evaluate precisely the market power and efficiency effects is extremely difficult. The question of whether the merged group will enjoy market power is uncertain, taking account a whole range of factors such as concentration levels, barriers to entry and buyer power. While some of these are capable of objective measurement, many are not and analysis of the relevant factors taken together is necessarily complex, and subjective. Therefore the enforcement authority of merger control embraces discretion to balance various considerations in merger review. See K Heyer, A World of Uncertainty: Economics and the Globalization of Antitrust, (2005) Volume 72 Issue 2, *Antitrust Law Journal*, pp.375-422.

¹⁷ See Recital 2 of EUMR and Article 1 of the AML 2008. See also the discussion of the substantive test of merger control in '4.2.1 Rewording the Substantive Test' in Chapter 3.

of the goals governing the application of merger control in various jurisdictions, particularly the US and the EU.¹⁸ The debate in the late 1980s among enforcers and academics has finally led to the view that competition law should primarily aim at an efficient working of the market, in order to maximise consumer welfare as the standard for the evaluation of practices under competition policy.¹⁹ In the EU this approach was confirmed several times by the former Commissioner for Competition Policy, Mario Monti.²⁰ Further, the Notice on Horizontal Mergers states that the goal of the Regulations is exclusively to protect consumer welfare:

Effective competition brings benefits to consumers, such as low prices, high quality products, a wide selection of goods and services, and innovation. Through its control of mergers, the Commission prevents those that would be likely to deprive customers of these benefits by significantly increasing the market power of firms.²¹

Although there are others who do not regard consumer welfare as the sole objective of merger control, the working assumption of merger analysis in the EU is the promotion of consumer welfare.²² According to article 1 of the AML 2008,

¹⁸ About the debate see, CD Ehlermann and LL Laudati, The objectives of competition policy European competition, in *European Competition Law Annual*, (Hart Publishing, 1998), 1; K Miert, European competition policy: a retrospective and prospects for the future, in *Annual Proceedings of the Fordham Corporate Law Institute: International Antitrust Law & Policy*, (Juris Publishing, 2000), pp. 1-12; Mario Monti, Speech at the UCLA Law First Annual Institute on US and EU Antitrust Aspects of Mergers and Acquisitions of February 28, 2004, Convergence in EU-US antitrust policy regarding mergers and acquisitions: an EU perspective, available at: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/04/449&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed on the 23rd April 2012).

¹⁹ A Pera and V Auricchio, Consumer Welfare, Standard of Proof and the Objectives of Competition Policy, (2005) Volume 1 Number 1, *European Competition Journal*, pp.153-177.

²⁰ Mario Monti stated that 'We both agree that the ultimate purpose of our respective intervention in the market-place should be to ensure that consumer welfare is not harmed.' See also comments of Mario Monti in response to a speech by Hew Pate in Brussels on 7th June 2004, emphasising that consumer welfare is the ultimate objective of both US and EU competition policy, available at: http://ec.europa.eu/competition/speeches/text/sp2004_005_en.pdf; (accessed on the 15th September 2013). For more speeches of Mario Monti on the objective of EU merger control see A Lindsay, *the EC Merger Regulation: Substantive issues*, Second Edition, (Sweet & Maxwell, 2006), pp.37-39.

²¹ Paragraph 8, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (hereinafter 'Guidelines on Horizontal Mergers'), [2004] O.J. C31/5.

²² There are three kinds of criteria for assessing competition law: consumer welfare considers whether the market delivers benefits to consumers; total welfare takes account of the interests of producers as well as consumers; and efficiency focuses on the way the market operates. For an introduction of

merger control in China also aims to prevent and restrain monopolistic conduct and safeguard the interests of consumers.²³ In published case decisions, the MOFCOM has blocked a merger or imposed commitments on notified concentrations because the mergers would impede effective competition in the relevant market to the detriment of consumer welfare.²⁴

ii. The Role of Enforcement Authorities in Merger Control

Recital 8 of the preamble to the EUMR makes clear that the Commission is the only body that can take decisions concerning concentrations with an EU dimension.²⁵ The European Commission has comprehensive authority to engage in investigation, decision making and imposing sanctions in relation to mergers with an EU dimension. In addition, it is responsible for issuing competition related guidelines to address the problems identified by the Commission.²⁶ The European Court of Justice and the General Court are only responsible for hearing appeals in relation to decisions taken (or not taken) by the Commission.²⁷ They do not have the authority to make antitrust merger decisions or impose sanctions directly. The position is similar in China: the MOFCOM is the only administrative authority in China which is in charge of legislation, reviewing and making final decisions in

these three criteria see A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 20, pp.1-25.

²³ Article 1 and Article 28, the AML 2008.

²⁴ For example, in *Coca cola/Huiyuan*, transaction was blocked because 'it will result in elimination and restraint of competition with existing fruit juice drinks enterprises and further damage the lawful interests and rights of the consumers'. In *Mitsubishi Rayon/Lucite*, notified transaction was cleared with restrictive conditions because 'it will have negative impact on effective competition in China's MMA market'. See section 4-1, *Coca cola/Huiyuan*, Announcement MOFCOM [2009] No.22; paragraph 1, section 5, *Mitsubishi Rayon/Lucite*, Announcement MOFCOM [2009] No.28.

²⁵ See Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (hereinafter 'EUMR'), [2004] O.J. L24.

²⁶ See W.P.J. Wile, *The Combination of the Investigative and Prosecutorial Function and the Adjudicative Function in EC Antitrust Enforcement: A Legal and Economic Analysis*, *World Competition: Law and Economics Review*, (2004) Volume 27 No.2 pp.202-224.

²⁷ The general right to appeal against actions of the Commission is set out in Article 230 of the EU Treaty. Article 21(1) EUMR also provides 'subject to review by the [ECJ] the Commission shall have sole jurisdiction to take the decisions provided for in this regulation'. Appeals of merger case decision are discussed in M Furse, *Competition law of the EC and UK*, Sixth Edition, (Oxford University Press, 2008), pp.189-201.

merger control.²⁸ The relevant court becomes involved only when any party concerned is dissatisfied with the decisions and appeals.²⁹

iii. Mission of integrating markets

The EU is an economic and political union of 28 member states. Each member state may compose an exclusive relevant market. The Commission aims to break down barriers to cross-border trade within the EU and to establish a single market in the EU within which there is free movement of goods, services, capital and workers.³⁰ The operation of administrative monopoly in China results in barriers to regional markets.³¹ The AML 2008 also aims to overcome administrative monopoly and reorganise local markets into a single national one.³²

In conclusion, these similarities lead to the adoption of the EU model as a reference for comparison, especially as the EU has a longer period of development of its merger control regime than China. In the process of development the regime became more transparent and complete. This experience can guide the newly born merger control processes in Chinese law. The history of merger control in the EU may for convenience be divided into three phases. The first is the period from the initial lacuna in the Treaty of Rome to the drive for merger control at the EU level.³³ In 1973 the Commission adopted its first legislative proposal for a merger control regulation. However, there was no consensus on the necessity for merger

²⁸ See '4.2.2.1 The Role of MOFCOM in China's Merger Control System' in Chapter 1.

²⁹ Article 53, the AML 2008.

³⁰ This is a feature unique to EU competition law. see J Goyder and A. A.Llorens, *EC competition law*, Fifth Edition, (Oxford European Union Law Library, 2009), 11

³¹ See '4.2.1.1 Barriers to Accessing Some Administrative Zones' in Chapter 1. Xinzhu Zhang and Vanessa Yanhua Zhang thought the geographic market in case *Inbev/Anheuser-Busch* was narrower than that of China. More detail regarding the notified transaction is available at '3.2 Factors Considered in Defining the Relevant Geographic Market' in Chapter 2. See X Zhang and V Zhang, *Chinese Merger Control: Patterns and Implications*, (2010) Volume 6 Issue 2, *E.C.L.R.*, pp. 482-486.

³² Abuse of administrative power to eliminate or restrict competition is regulated under Chapter 5 of the AML 2008. In general, any administrative organ or organization empowered by a law or an administrative regulation to administer public affairs is not allowed to abuse its administrative power to block free circulation of commodities between regions. See Articles 32 to 37, the AML 2008.

³³ The European Coal and Steel Community Treaty (hereafter ECSC treaty) contained provisions for controlling mergers, but it was not adopted in the EEC Treaty. For the climate of merger control in the EU before the adoption of Council Regulation (EEC) No 4064/89 see T A Downes and J Ellison, *the Legal Control of Mergers in the European Communities*, (Blackstone Press Limited, 1991), pp.1-33.

control among Member States. The second phase is the period of application of Articles 81 and 82 of the EC Treaty (currently Articles 101 and 102 of The Treaty on the Functioning of the European Union). Prior to the adoption of the European Community Merger Regulation (ECMR) the Commission relied, where possible, on Articles 81 and 82 of the EC Treaty in prohibiting some mergers. Nevertheless, the application of Articles 81 and 82 has its own problems; the process of review is long and uncertain and the scope of merger review is undetermined.³⁴ The third phase of merger control in the EU is characterised by the issue of EC Merger Control Regulation (EEC) 4064/89 (ECMR).³⁵ Subsequent amendments were proposed in the implementation of ECMR 4064/89. In response to the 1996 Green Paper reviewing the ECMR Regulation 1310/97 introduced some amendments to the ECMR.³⁶ After that the 2001 Green paper mooted jurisdictional, substantive and procedural matters set out in the ECMR.³⁷ As the outcome of the negotiation and discussion of the 2001 Green paper, the EU Merger Regulation was adopted and published in the Official Journal on 20 January 2004.³⁸ The regulation is supplemented by an implementing Regulation and a series of Commission Notices which provide guidance to the interpretation of various provisions of the Merger Regulation.

1.4.2 Differences in Context between the EU and China

There are differences in the context between the EU and China for assessing horizontal mergers reduce the significance of comparison, and which are acknowledged throughout this thesis.

³⁴ See D Neven and L Röller, Discrepancies between Markets and Regulators: an Analysis of the First Ten Years of EU Merger Control, (August 2002), *HEI Working Paper No: 10/2002*, available at: http://graduateinstitute.ch/files/live/sites/iheid/files/sites/international_economics/shared/international_economics/publications/working%20papers/2002/HEIWP10-2002.pdf (accessed on the 30th September 2013); N Levy, EC Merger Control: From Birth to Adolescence, (2003) Volume 26 Issue 2, *World Competition*, pp.195-218.

³⁵ Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, (1989) O.J. L 395/1.

³⁶ Community Merger Control Green Paper on the Review of the Merger Regulation, COM (96) 19, January 1996; Council Regulation (EC) No 1310/97 of 30 June 1997 amending Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, (1997) O.J.L180/1.

³⁷ Green Paper on the Review of Council Regulation (EEC) No 4064/89, COM (2001) 745, December 2001.

³⁸ See *supra* note 25.

i. The impact of non-competitive considerations on merger assessment

In addition to protecting market competition and consumer welfare, antitrust merger assessment in China also has another purpose. According to Article 1 of the AML, merger assessments may take into account issues such as ‘enhancing economic efficiency’, ‘safeguarding the interests of social public interest’ and ‘promoting the healthy development of the socialist market economy’. There is no further legislation or guidelines which clarify these concepts. These concepts have not been applied in the published case decisions. Therefore, it is too early to evaluate the MOFCOM’s assessment of these factors in merger control, or compare their enforcement with the EU.

ii. Judicial review of merger decisions

In the EU the General Court will annul the Commission’s decision when there are ‘manifest errors’.³⁹ Generally, the contribution of judicial review on merger assessment can be analysed from three aspects, namely interpretation of the EU Merger Regulation,⁴⁰ review of the substantive issues of merger assessment⁴¹ and reviews of the procedures applied.⁴² However, as judicial review in China is not independent and is in fact ineffective, its contribution on correcting mistakes in the MOFCOM’s merger assessment is limited.⁴³

³⁹See case T-5/02, *Tetra Laval v. Commission*, [2002] E.C.R. II-4381; Cases T-342/99, *Airtours v. Commission*, [2002] E.C.R. II-2585;

⁴⁰In particular the court emphasises on constructing the meaning of the provisions of the EUMR. The General Court have interpreted the ‘dominant’ test, under the 1989 ECMR, that it applied to cases of collective as well as individual dominance. See case T-102/96 *Gencor v. European Commission* [1999] E.C.R. II-753; a situation of collective dominance could be based on three cumulative factors. See case T-342/99 *Airtours v Commission* [2002] E.C.R II-02585, paragraph 62.

⁴¹The General Court reviews the evidence to verify if the factual findings are based on ‘cogent and consistent evidence’. See Case C-12/03 *Commission v Tetra Laval* [2010] E.C.R. I-00067, paragraph 27; In addition, it checks whether the reasons for conclusions are consistent with those factual findings and confirms whether or not the Commission has made any ‘manifest errors’. See Case T-5/02, *Tetra Laval v. Commission* [2002] ECR II-4381, paragraph 132. See also M Clough, the Role of Judicial Review in Merger Control, (2003-2004) Volume 24, *Northwestern Journal of International Law & Business*, 733.

⁴²In *Schneider*, the General Court defined the relationship between the Commission’s Statement of Objections (SO) and the final decision. See Case T-310/01 *Schneider Electric v Commission* [2002] E.C.R. II-4071, points 445.

⁴³See ‘4.2.3 Ineffectiveness of Judicial Review’ in Chapter 1.

iii. Imbalance of information for comparison between the EU and China

Compared with the extensive regulations, case decisions and articles regarding merger control in the EU, there are only 13 (short) relevant guidelines and 19 published merger case decisions in China as of 30 June 2013. A number of factors which are listed in the AML2008 or guidelines are of limited value. There is no further explanation or discussion on how those factors are considered, nor evidence published concerning how these factors have influenced the MOFCOM in any particular case.⁴⁴ This limits the conclusions which may be drawn at present in relation to the practice of the MOFCOM in some areas.

2 Structure of the Thesis

This thesis consists of six chapters, including an Introduction and conclusion. It criticises the approach of appraising a proposed concentration under the AML2008 in China. It questions whether merger analysis by MOFCOM is able to predict the effect of any given concentration on the competitive process. It also questions whether the process of merger analysis as reflected in merger decisions is transparent. As currently practised, merger review consists of three fundamental steps: 1) the delineation of relevant markets; 2) examination of specific market factors to determine the extent to which the proposed merger would increase market power and thus harm the market competition; and 3) assessment of rebutting factors that could offset any harms due to increased market power.⁴⁵ In Chapter 2 the approach of defining the relevant market in China is compared with the comparative approach in the EU. Market definition is a necessary pre-condition for assessment of a concentration; it is a starting point for a competitive analysis and not an end. Two goods or services are in the same relevant market if and only if customers view them as sufficiently close substitutes. In this chapter the questions that need to be answered are: what does 'sufficiently close' substitution

⁴⁴ Factors leaving for research in future include 'efficiency created by the merger', 'failing firm defence', 'the effects of merger on national economic development and on public interest'. This standpoint is also expressed in note 2 of Chapter 5, 168.

⁴⁵ Steps of merger review is confirmed in M K Katz and H A Shelanski, *Merger Analysis and the Treatment of Uncertainty: Should We Expect Better?*, (September, 2006), *UC Berkeley Public Law Research Paper No.821234*, 538.

mean? What approach is adopted in analysing the substitute relationship between products? Is the process of defining 'relevant market' clarified in MOFCOM's case decision, comparing with the merger decisions in the EU is transparent.

Chapters 3 and 4 review anti-competitive concerns in horizontal mergers.⁴⁶

Horizontal mergers produce two consequences that do not arise in either vertical or conglomerate mergers. A horizontal merger may remove important competitive constraints in a concentrated market and, consequently, the market power of the merged entity might be increased. The reduction in these competitive constraints could lead to significant price increases in the relevant market.⁴⁷ Generally, such price increases can occur through two channels. Unilateral effects mean a merger would create or strengthen the dominant position of the merging firm and, consequently, it will be able to raise its price without losing sales. Co-ordinated effects means a merger would create or strengthen a collective dominant position. Therefore it increases the likelihood that firms are able to coordinate their behaviour in this way and raise prices, even without entering into an agreement or resorting to a concerted practice.⁴⁸ Chapter 3 focuses on the approach of evaluating unilateral effects in China. Assessment of co-ordinated effects will be conducted in Chapter 4. Through comparison each chapter intends to explore the question whether competitive analysis is explained clearly in law and case decision in China and whether the result of competitive assessment is able to reflect the effect of merger on the competitive process properly.

Chapter 5 evaluates the countervailing factors to anti-competitive issues. Even though a merger is predicted to cause competitive harm to consumers, there are still countervailing factors which are likely to ensure that consumers are not harmed by the merger. In the Interim Rules factors which can counter the anti-

⁴⁶ A horizontal merger is one which occurs between firms operating in the same market. See H Hovenkamp, *Federal Antitrust Policy: The Law of Competition and Its Practice*, Third Edition, (Thomson West, 2005), 500.

⁴⁷ Apart from price increase the merged group is also able profitably to reduce quality, choice or innovation as the reduction of its competitive constraint. See paragraph 24, Guidelines on Horizontal Mergers.

⁴⁸ Paragraph 39, Guidelines on Horizontal Mergers. See also Case T-102/96 *Gencor v Commission*, [1999] ECR II-753, paragraph 277; Case T-342/99 *Airtours v Commission*, [2002] ECR II-2585, paragraph 61.

competitive effect on consumers are listed.⁴⁹ In addition to economic efficiency, MOFCOM also considers the countervailing new entry; whether buyers can exert an offsetting power over the concentration's anti-competitive effect (buyer power) and whether the merging parties are 'on the verge of bankruptcy' (i.e. failing firm defence). If the business operators concerned can prove that the concentration gives rise to countervailing benefits which 'obviously' outweigh its negative impact, or it is in accord with the public interest, MOFCOM may decide not to prohibit the concentration.⁵⁰ The Interim Rules does not provide any details on how to calculate or measure these factors. To date factors of countervailing market entry and buyer power have been considered in published cases.⁵¹ Their method of analysis and transparency in case decisions will be compared with their counterparts in the EU. Other potential defences, namely efficiency and failing firm factors, cannot restrain the market power of the merged entity. They are taken as exemptions of prohibition or raising sharp commitments when anti-competitive effect of merging parties has already existed. Accordingly these two factors are not discussed further in this thesis. Finally, the conclusion of the thesis is presented in chapter 6. It contains two aspects. First, whether the merger analysis in China can predict the effects of concentration on market competition? Second, to what extent does the legislation and case decisions make transparent to the public how MOFCOM weighs all the variables in their enforcement decisions? Both of these two questions are analysed with reference to merger review in the EU.

3 Methods of Research

The comparative method is essential in this thesis. The MOFCOM is often criticised for its lack of experience of merger examination.⁵² Some may then question

⁴⁹ Articles 7 to 13, Ministry of Commerce of the People's Republic of China, Announcement No. 55 of 29th August 2011, Interim Rules on Evaluating Competitive Effects of Concentration of Business Operators (hereinafter 'Interim Rules').

⁵⁰ Article 28, the AML2008.

⁵¹ See the discussion in chapter 5.

⁵² See Y Huang, Pursuing the second best: the history, momentum, and remaining issues of China's anti-monopoly law, (2008) Volume 75 Issue1 *Antitrust law Journal*, pp. 231-265; X Wang, Comment on Operators Concentration in Anti-Monopoly Law of people's Republic of China [中华人民共和国反垄断法中经营者集中制度的评析, *Zhonghua renmin gongheguo fanlongduanfa zhong jingyingzhejizhong*

whether the authorities in China can adopt and apply various competition law techniques from large, developed bodies such as the EU.⁵³ If it can, how much can it modify particular legal techniques, considering its own economic, political, and social consequences? In general it legitimately can be assumed that competition authorities with a short history should adopt legal and economic structures from advanced competition regimes, regardless of their different economic and social structures. In particular, this assumption seems plausible when competition authorities rely heavily on the universalism of economic theories.⁵⁴ This comparative analysis can offer a larger variety of solutions than could be made in a system within one country. The MOFCOM can learn from other regimes' legal practices, which may give guidance on better paths of development, and modify them to fit their own economy and market.

In addition, historical analysis will also be applied. In the introduction, the development of merger control in China requires a historical investigation. Through the historical review, the disparities of market situation and legal circumstance between China and EU can be found out. These differences will be considered when learning the experience from the EU.

zhidu de pingxi], (2008) Volume1 *Law Journal* [法学杂志, *faxue zazhi*], pp. 2-7; J Shi, Thinking about complement of the system of defense against the substantial test of merger control [完善我国经营者集中实质审查抗辩制度的思考, *Wanshan Woguo Jingyingzhe Jizhong ShizhiShencha KangbianZhidu de Sikao*], (2009) Volume 12, *The Law* [法學, *Fa Xue*], pp.102-109.

⁵³ In this thesis reference is set as the merger control regime in the EU. The comparison of merger control of China and other regimes can be conducted in future research.

⁵⁴ The economic basis of merger control is available at Part III—Measurement in S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, Second Edition, (Sweet & Maxwell, 2002), pp.317-456.

4 Historical Development of the Chinese Economy and Competition Law

4.1 No Tradition of Anti-monopoly Analysis of Concentrations

At the Third Plenary Session of the Eleventh Central Committee the Communist party of China made a decision which redirected the focus of its work from ‘class struggle’ to construction of the economy.⁵⁵ Since this policy change in 1978, economic reform in China has been an ongoing project. In this process China has experienced the transition from a social planned economy to a socialist market economy.⁵⁶ A planned or command economy is an economic system in which the central government makes all decisions on the production and consumption of goods and services.⁵⁷ In order to construct the socialist market economic system, market forces rather than central government should play the basic role in allocating resources.⁵⁸ During the transition the purpose of merger control was changed. The following section will review the development of merger control in China. The tradition and features of merger control in history may have some influence on the development, expression, and application of merger control in the present.

⁵⁵ The announcement of the Third Plenary Session of The Eleventh Central Committee, *People's Daily*, (Beijing, 24th December 1978), 1, available at: <http://baike.baidu.com/view/1975390.htm?fr=ala0> (accessed on the 7th December 2009).

⁵⁶ In 1993, the second constitutional amendment was passed in the Eighth National People's Congress of the People's Republic of China. According to article 7 of this amendment, the state changed from implement of planned economy to socialist marketing economy. For an unofficial translation of this amendment can refer to: http://portal.gov.mo/web/guest/info_detail?infoId=103 (viewed on the 23 September 2010).

⁵⁷ The Editorial office, *Encyclopaedia of China*, Second Edition, (Press of Encyclopaedia of China, 2009).

⁵⁸ The Decision on Solving Some Problems in Establishment of Socialist Market Economy System was promulgated by the Central Committee of the Communist Party of China in 1993. The Official Chinese Version is available at http://www.cass.net.cn/zhuanti/2008ggkf/show_News.asp?id=228951 (viewed on the 24th September 2010). No English translation was available at the time of writing this thesis.

4.1.1 Encouraging Mergers between the SOEs between 1978 and 1993

As a tool to realise the industrial policy of the planned economy, regulations on merger control were promulgated by state authorities. In 1986 Regulations to Further Push the Development of Horizontal Alliance in [the] Economy were passed by the State Council.⁵⁹ In 1987 the former State Commission for Restructuring the Economic System and the former State Economic and Trade Commission together published Suggestions on Construction and Development of Business Conglomerates.⁶⁰ In 1989 four authorities jointly published The Provisional regulations on merger.⁶¹

These regulations encouraged horizontal mergers and the formation of group enterprises among State Owned Enterprises (SOEs). The purpose was to reduce the losses of SOEs.⁶² It planted a seed for the establishment of SOEs' dominant positions in the market. Anti-monopoly was only proposed as a principle of regulation existing alongside other principles.⁶³ There was no threshold on the

⁵⁹ Regulations for Further Pushing the Development of Horizontal Alliance in Economy, [国务院关于进一步推动横向经济联合若干问题的规定 Guowuyuan Guanyu Jinyibu Tuidong Hengxiang Lianhe Ruogan Wenti De Guiding], which was promulgated by the State Council of China on 23rd March 1986. It was repealed in 2000. The official Chinese version is available at: http://law.baidu.com/pages/chinalawinfo/0/27/859f16fa6c4ee582e2e3dd6b59cbd137_0.html (viewed on the 23rd September 2013). There is no English translation during thesis.

⁶⁰ Suggestions on Construction and Development of Business Conglomerate [国家体改委、国家经委关于组建和发展企业集团的几点意见 Guojia Tigaiwei, Guojia jingwei guanyu Zujian he Fazhan Qiyejituan de Jidian Yijian] was promulgated by the State Commission for Restructuring the Economic System and State Economic Commission on 16th December 1987. It has been ceased. The official Chinese version is available at: <http://www.people.com.cn/item/flfgk/gwyfg/1987/232101198707.html> (Viewed on the 7th September 2013). As above.

⁶¹ The Interim Regulation on Merger [国家体改委、国家计委、财政部、国家国有资产管理局关于企业兼并的暂行办法 Guojia Tigaiwei, Guojia jiwei, Caizhengbu, Guojia guoyouzichan Guanliju Guanyu Qiyejianbing de Zanxing banfa] was jointly released by the former State Commission for Restructuring the Economic System, the State Development Planning Commission, Ministry of Finance, the National State-Owned Assets Administration on 19th February 1989. It was repealed in 2000. The official Chinese version is available at: http://www.law-lib.com/law/law_view.asp?id=5554 (Viewed on the 7th September 2013). As above.

⁶² Article 2, Suggestions on construction and development of business conglomerate, *supra* note 44.

⁶³ For example, in the Interim Regulation on Merger, anti-monopoly is one of six principles that concentrations should follow. In addition to the aim of anti-monopoly, mergers should also accord with the strategy of economic development and industry policy; optimise the industrial structure, product

concentrations which might be reviewed under an anti-monopoly process, nor were there measures set out in relation to concentrations which might have the effect of lessening competition in the market.⁶⁴

4.1.2 Driving for Regulating Mergers between Enterprises with Foreign Investments between 1993 and 2003

In light of the development of market structures, legislation concerning competition was speeded up in this period. Based on the Anti-Unfair Competition Law,⁶⁵ a number of regulations concerning competition were passed.⁶⁶ The Provision on the Merger and Division of Enterprises with Foreign Investment in this period was applied in relation to the regulation of mergers and the division of enterprises, and protecting the interests of enterprises and individuals concerned in merger and division.⁶⁷

structure and organisational structure of the enterprises; and promote scale economy etc. The Interim Regulation on Merger, *supra* note 46.

⁶⁴ M Du and H Li, Merger control in the state of economic transformation which is based on Anti-monopoly: the Example of China [经济转轨国家中企业并购的反垄断法规制: 对中国的个案研究 Jingji Zhuangui Guojizhong Qiye Binggou de Fanlongduanfa Guizhi] in D W Cheng and J F Li, *An Exploration of China's Legislation on Competition*[中国竞争法立法探要, *zhongguo jingzhengfa lifa tanyao*], (Social Sciences Academic Press, 2006), 83.

⁶⁵ Anti-Unfair Competition Law of the People's Republic of China [中华人民共和国反不正当竞争法, *Zhonghua Renmin Gongheguo Fanbuzhengdang Jingzhengfa*] was promulgated by the Standing Committee of the National People's Congress and effective on the 9th February 1993. For an official English translation see: <http://en.chinacourt.org/public/detail.php?id=3306> (viewed on the 24th September 2013).

⁶⁶ Such as Price Law of People's Republic of China [中华人民共和国价格法, *Zhonghua Renmin Gongheguo Jiagefa*], adopted at the 29th Meeting of the Standing Committee of the Eighth National People's Congress on the 29th December 1997, entered into force on the 1st May 1998. An English translation can be seen at: <http://www.82invest.com/UploadFile/price%20law.pdf> (viewed on the 24th September 2010); and Law of the People's Republic of China on Bid Invitation and Bidding Law [中华人民共和国招标投标法, *Zhonghua Renmin Gongheguo Zhaobiao Toubiaofa*] was adopted at the 11th Meeting of the Standing Committee of the Ninth National People's Congress on the 30th August 1999, promulgated on the 30th August, and entering into force on the 1st January 2000. An English version can be seen at: <http://www.asianlii.org/cn/legis/cen/laws/biabl226/> (viewed on the 24th September 2013)

⁶⁷ Provision on the Merger and Division of Enterprises with Foreign Investment [关于外商投资企业合并与分立的规定, *Guanyu Waishang Touzi Qiye Hebing yu Fenli de Guiding*] were promulgated by the Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce on the 23rd September 1999. This amendment was issued on the 22nd November 2010. The analysis in this thesis is based on the amendment of 2010. An unofficial translation can be found at: http://www.eduzhai.net/yingyu/615/763/yingyu_246912.html (Viewed on the 24th September 2013). According to Article 1 the provision its purpose is to standardise acts involving merger or

These Provisions were only applicable to mergers or division between Chinese-foreign joint ventures, Chinese-foreign cooperative joint ventures with legal personality status, wholly foreign-owned enterprises and companies limited by shares with foreign investment, which had been established in China pursuant to China's laws.⁶⁸

In accordance with Article 26 of this Provision the administrative department for reviewing and approving mergers was the Ministry of Foreign Trade and Economic Cooperation (hereafter MOFTEC)⁶⁹. When MOFTEC found that a merger could lead to monopoly in a relevant market and impede free competition it would hold a hearing with other departments, investigate and collect evidence from the parties to the merger and analyse the condition of the relevant market. The regulation did not set out what the MOFTEC would do after any investigation and hearing. In the process of investigation and hearing the parties which would be involved were not clearly specified. This opaque approach rendered the enforcement of merger control based on anti-monopoly ineffective. Nor was there any threshold for MOFTEC to decide whether a concentration should be subject to an anti-monopoly review. There was no definition of 'monopoly' provided in the regulation. The discretion left to MOFTEC ensured that the merger parties could not predict the result of any merger review.

In conclusion, regulations in this period showed that the government realised the possibility that mergers could lead to monopolies in markets, and that it had the intention to control this trend to monopoly through concentration. Nevertheless, the incomplete legislation made this intention hard to implement.

division of foreign investment enterprises and to protect the lawful rights and interests of investors and creditors of enterprises.

⁶⁸ Article 2, *ibid.*

⁶⁹ In March 2003 The MOFCOM was established. It undertakes some functions of the MOFTEC, the National Development and Reform Commission and State Economic and Trade Commission. The MOFCOM is one of administrative departments composing the State Council.

4.1.3 Control of Concentrations Relating Foreign Investors during the Period 2003-2008

China joined the World Trade Organization (WTO) on the 11th December 2001.⁷⁰ Foreign-related acquisitions were stepped up and began to threaten the WTO liberalised sectors. The government was pushed into the creation of merger control regulations, particularly mergers involving foreign investors.⁷¹ The Interim Provisions on mergers and acquisition of domestic enterprises by foreign investors was promulgated in 2003.⁷² It was the first legislation in China which established a review system applying anti-monopoly principles to concentrations. It established a framework for an effective merger control system. The threshold of merger control, analytical considerations, exemptions from prohibition, enforcement and procedure of merger control were all dealt with in these provisions. However, there were a number of omissions.

The Interim Provisions was only applicable to the acquisition of domestic enterprises by foreign investors.⁷³ That is to say only mergers concerning existing foreign-funded enterprises would fall to be considered in review. Mergers between domestic enterprises only or involving a foreign investor who had not yet invested in China were outside the scope of the merger and acquisition system. This created differential treatment of concentrations determined purely by ownership type, without consideration of economic effects.

A threshold for review was established in these regulations.⁷⁴ Market revenue and market share were set as two factors of threshold. However, the regulations lack further explanation as to how to assess market revenues and market shares. This

⁷⁰ The Chinese government accepted the Protocol on the Accession of the WTO on the 11th November 2001. For the text of the Protocol on the Accession of WTO can see World Trade Organization, *Protocol on the Agreement of the People's Republic of China to the Marrakesh Agreement Establishing the World Trade Organization*, (Cambridge University Press, 2003).

⁷¹ M Williams, *Competition policy and law in China, Hong Kong and Taiwan*, (Cambridge University Press, 2005), 198.

⁷² For an introduction to the Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (hereinafter 'the Foreign M&A Regulations 2006') see *supra* note 8.

⁷³ Article 2, *ibid.*

⁷⁴ Article 51 and article 53, *ibid.*

lacuna meant that the results of any analysis would be unpredictable. The threshold also contains the number of enterprises in the relevant domestic market which are taken over by the same foreign investor within one year.⁷⁵ This may prevent a company from assuming a dominant or monopoly position through a chain of 'small' acquisitions. Nevertheless, it did not introduce a standard by which to assess the accumulated market power acquired.⁷⁶ If all the acquired companies had low market power, such a process of merger might not seriously harm competition.

In addition, 'in the event that an acquisition does not meet the threshold of merger control, the MOFCOM or the State Administration for Industry and Commerce (SAIC) still had the power to open a case when they considered, upon request by a domestic enterprise in a competitive relationship to the merging parties, or a relevant functional department or industrial association, that the acquisition by the foreign investor involved a substantial market share, or there were other major factors which materially impacted market competition'.⁷⁷ In such a situation the foreign investor could be required to make a report to the MOFCOM or the SAIC, which could take further action. However, the lack of any definition of the term 'other major factors' resulted in the threshold of merger control's being opaque, and an inability of merging parties to anticipate the demands of a merger review process.

The regulations provide that in merger and acquisition of domestic enterprises foreign investors should not create excessive concentration in the domestic market, eliminate or hinder domestic competition, disturb the social economic order or harm the societal public interest.⁷⁸ These elements were considerations in the examination of mergers. However, there was no definition of 'excessive concentration', 'social economic order' or 'societal public interests'.

⁷⁵ Article 51 (2) and article 53 (5), *ibid*.

⁷⁶ M. Williams, *Competition Policy and Law in China, Hong Kong and Taiwan*, (Cambridge University Press, 2005), pp.177-191.

⁷⁷ Article 51, the Foreign M&A Regulations 2006, *supra* note 8.

⁷⁸ Article 3, *ibid*.

When the MOFCOM and the General State Administration for Industry and Commerce (GSAIC) considered that the merger could cause excessive market centralization, hinder fair competition or damage consumers' benefits, they had the power, within 90 days of the receipt of all the documents, either solely through negotiation or jointly, to convene the relevant departments, institutions, enterprises and other interested parties and hold a hearing, and could decide whether to grant approval in accordance with the law.⁷⁹ However, there were no guidelines on the conditions of solely or jointly reviewing merger, or in relation to the relative powers of each administrative department involved in the review.

To sum up, first of all in China there was no tradition of anti-monopoly analysis in merger control. The purpose of merger control was mixed with competition goals and non-competition goals. In the past merger control was used as a tool to solve specific problems under various market conditions. It existed to reduce the losses in SOEs⁸⁰ or to deal with a threat from foreign investors.⁸¹ Competition policy targeting anti-monopoly was weak.

Secondly, merger control under an anti-monopoly standard did not exist as an independent process. It was mixed in with the content of control which was to protect the shareholders of merger parties as well as the orderly framework of merger transaction, for instance in the Foreign M&A Regulations 2006.

Thirdly, a majority of provisions on merger control were scattered in many 'interim administrative rules'.⁸² The legal authority of administrative rules in China's legal system is relatively low. According to the Legislation Law of The

⁷⁹ Article 52, *ibid*

⁸⁰ See 4.1.1 Encouragement of merger between 1978 and 1993.

⁸¹ See 4.1.3 Formulation of merger control on anti-monopoly to foreign investors during the period 2003-2008.

⁸² Pursuant to article 71 of The Legislation Law of The People's Republic of China, 'The various ministries, commissions, the People's Bank of China, the Auditing Agency, and a body directly under the State Council exercising regulatory function, may enact administrative rules within the scope of its authority in accordance with national law, administrative regulations, as well as decisions and orders of the State Council'. The law was adopted at the third Session of the Ninth National People's Congress on March the 15th 2000 and was enacted on the 1st July 2000. The official translation can be found at: http://english.gov.cn/laws/2005-08/20/content_29724.htm (Viewed on the 17th September 2013).

People's Republic of China, legislation in China can be divided into various levels:⁸³ the Constitution of the People's Republic of China has the highest legal authority;⁸⁴ National law lies on the second level;⁸⁵ Administrative regulations lie on the third level;⁸⁶ the fourth level of legal authority is local decrees and administrative rules.⁸⁷ They are implemented within their respective scope of authority; a local decree has higher legal authority than local rules issued by governments at the same and lower level.

Fourthly, the conduct of enforcement authorities and their powers were opaque. As in the Foreign M&A Regulations 2006, the enforcers of merger control on anti-monopoly were the Ministry of Commerce of the People's Republic of China (MOFCOM) and the General State Administration for Industry and Commerce (GSAIC).⁸⁸ However, there was no guideline on the conditions of solely or jointly reviewing mergers, nor any interpretation of the boundary of power for each administrative department in reviewing merger as well. This could have resulted in conflict of jurisdiction between these two authorities and opportunity for them to abuse their powers in investigation.

4.1.4 Independence of Merger Control under an Anti-monopoly Standard

As China's first comprehensive competition law, the AML 2008 unites the loose legislation on competition that existed in China before its enactment. Merger

⁸³ For legally binding force of various statutes see articles 78 to 82 of The Legislation Law.

⁸⁴ The Constitution of the People's Republic of China was adopted by the 5th National People's Congress on the 4th December 1982 with further revisions in 1988, 1993, 1999, and 2004. The official English translation can be found at: http://www.npc.gov.cn/englishnpc/Constitution/node_2825.htm (viewed on the 24th September 2013).

⁸⁵ The National People's Congress and Standing Committee thereof shall exercise state legislative power. The National People's Congress enacts and amends Criminal, Civil, and State organic law and other basic law. The Standing Committee of National People's Congress enacts and amends laws other than those to be enacted by the National People's Congress; See Article 7 of the Legislation Law, *supra* note 65.

⁸⁶ Administrative regulation was enacted by the State Council. See Article 63, the Legislation Law.

⁸⁷ Pursuant to Article 63 of the Legislation Law, the People's Congress of a province, autonomous region and municipality directly under the central government and the Standing Committee thereof may enact local decrees.

⁸⁸ Article 52, the Foreign M&A Regulations 2006, see *supra* note 8.

control on an anti-monopoly standard is at last separated from Foreign M&A Regulations 2009⁸⁹. Drafting of the AML 2008 China started in 1994,⁹⁰ but it was not enacted until August 2007. A series of drafts were proposed in the process.⁹¹

In order to interpret the provisions of the AML 2008 on merger control, twelve guidelines had been promulgated by the central government by June 2013. The AML 2008 and the twelve guidelines constitute the Chinese merger control regime at present. By June 2013 nineteen merger decisions had been published under the AML 2008.⁹² Eleven of these nineteen concentrations have an EU dimension pursuant to Article 1(2) of the EUMR and have been assessed by the European Commission as well.

4.2 Market Situation for the Implementation of Merger Control in China

The situation of politics, economy and culture is the background for the formulation and enforcement of merger control. It may influence the implementation of the purpose of merger control. Some features of the market situation in China will be introduced as background to merger control. Their differences from the conditions in the EU will be considered and compared in the relevant chapters.⁹³

⁸⁹ According to article 51 of the provisions of Foreign M&A Regulations 2009, where mergers and acquisitions of a domestic enterprise by a foreign investor meet the thresholds of antitrust merger control, the foreign investor shall make a declaration with the MOFCOM and shall not carry out the deal without such declaration. An unofficial English translation of the Foreign M&A Regulations 2009 is available at: http://www.bjreview.com.cn/document/txt/2009-08/17/content_212277.htm (viewed on the 24th September 2013).

⁹⁰ B M Owen *et al.*, China's Competition policy reforms: the anti-monopoly Law and beyond, (2008) Volume 75 No.1, *Antitrust Law Journal*, 236.

⁹¹ The first draft was promulgated in 1999. This draft provided an initial framework for merger control. Modifications based on version 1999 were issued nearly every year. The 2001 draft has not been officially published in Chinese or in English. In 2005 there were three draft versions.

⁹² No official English translation of these decisions was available during this study.

⁹³ The market situation in China can be seen in Y Jung and Q Hao, the New Economic Constitution in China: A Third Way for Competition Regime? (2003) Volume 24 Issue 1, *Northwestern Journal of International Law & Business*, pp.107-172; A Emch, The Chinese Anti-Monopoly Law and Its Structure Shortcomings, (August, 2008) *Global Competition Policy Magazine*, available at: <http://ssrn.com/abstract=1221922> (accessed on the 13th May 2012). Y Huang, Pursuing The Second

4.2.1 The Role of Government in Merger Control

Market economy is the foundation for implementing anti-monopoly law.⁹⁴ The social economy market was adopted in China in 1993. Even now the role of government in China still has features of the planned economy. Its influence also seeps into the process of merger control.

4.2.1.1 Barriers to Accessing Some Administrative Zones

In China the barriers to accessing some regional markets are high. The situation should be considered in defining the scope of relevant geographic market in merger assessment.

Local government at several levels uses its administrative power to establish barriers to fair competition between local and non-local enterprises.⁹⁵ Through formulation of local rules local government can grant privileges to local enterprises. They may provide credit aid, tax and land preference, and will favour local corporations in government procurement. Non-local enterprises will come across restriction from local government in sales quantity, price, tax policy and so on.

Best: The history, Momentum and Remaining Issues of China's Anti-monopoly Law, *supra* note 36, pp.117-131; X Wen, Market Dominance by China's Public Utility Enterprises, (2008) Volume 75 No.1, *Antitrust Law Journal*, pp.151-171; E M Fox, An Anti-monopoly Law for China-Scaling the Walls of Government Restraints, (2008) Volume 75 No.1, *Antitrust Law Journal*, pp.173-104; R H Pate, What I Heard in The Great Hall of the People—Realistic expectations of Chinese Antitrust, (2008) Volume 75 No.1, *Antitrust Law Journal*, pp.195-211; D J Gerber, Constructing Competition Law in China: The Potential Value of European and U.S. Experience, (2004) Volume 3 Issue 2, *Washington University Global Studies Law Review*, pp.315-331; Z Huo, A Tiger Without Teeth: The Antitrust Law of the People's Republic of China, (2008) Volume 10 Issue 1, *Asian-Pacific Law & Policy Journal*, pp.32-61; C Wu and Z Liu, A Tiger without Teeth? Regulation of Administrative Monopoly under China's Anti-Monopoly, (2012) Volume 41 Issue 1-2, *Review of Industrial Organization*, pp.133-155; D J Gerber, Constructing Competition Law in China: The Potential Value of European and U.S. Experience, (2004) Volume 3 Issue 2, *Washington University Global Studies Law Review*, pp.315-331.

⁹⁴ J Sun, The Implementation of China's Anti-Monopoly Law: A Case Study of Coca-Cola's Abortive Acquisition of Huiyuan Juice, (2009) Volume 6 Issue 1, *Frontiers of Law in China*, 117.

⁹⁵ According to Article 95 of the Constitution 1982, People's congresses and people's governments in China are established in provinces, municipalities directly under the Central Government, counties, cities, municipal districts, townships, nationality townships and towns. The legislator and enforcer of unfair local rules are people's governments at various levels.

They have to face high barriers from both local government and local enterprises with market power.⁹⁶

Given the existence of high barriers in various local markets it is difficult to form a high level of state-wide concentration. However, each local enterprise may have a large market share in its own district. This thesis does not analyse the reasons for such barriers. It is a fact of the market situation in China which should be considered in merger control, especially in defining a local rather than nation-wide geographic market.

4.2.1.2 Barriers to Accessing Specific Industries

According to Article 7 of the AML 2008,

With respect to the industries controlled by the State-owned economy and concerning the lifeline of national economy and national security or the industries lawfully enjoying exclusive production and sales, the state shall protect these lawful business operations conducted by the business operators therein.

This article provides that the state accepts and protects the monopoly of SOEs in particular industries. Except the SOEs other types of enterprise might find it hard

⁹⁶ The issue of regional protectionism in China is discussed by C Bai *et al.*, Local protectionism and regional specialization: evidence from China's industries, (2004) Volume 63, *Journal of International Economics*, pp. 397 – 417; X Li, The effect of market disconnection because of regional protectionism to the market structure [源于地方保护的市场分割对市场结构的影响 Yuanyu Difangbaohu de Shichang Fenge dui Shichang Jiegou de Yingxiang], (2010) volume 7, *Special Zone Economy [特区经济 Tequ Jingji]*, pp.289-291; D Zhang and J Wang, The issues and solutions on regional administrative monopoly, [论区域性行政垄断的问题与应对 Lun Quyxing Xingzheng Longduan de Wenti yu Yingdui], (2010) volume12 No. 3, *Journal of Liaoning University of Technology (Social Science Edition)*[辽宁工业大学学报(社会科学版) Liaoning Gongye Daxue (Shehui Kexueban)], pp.5-8; Q Ding, Analysing the issues of administrative protection in some industries of China and the government regulation [论政府规制与中国的行业性行政垄断 Lun Zhengfu Guizhi yu Zhongguo de Hangyexing Xingzheng Longduan], (2010) Volume8 No.4, *Journal of Hubei University of Economics*[湖北经济学院学报, Hubei Jingji Xueyuan Xuebao], pp.88-93.

to access these sectors which are not open to market competition. The SOEs' dominant position in these sectors is prevented from scrutiny by the AML2008.⁹⁷

4.2.1.3 The Owner of State Assets

As players in the market State-Owned Enterprises (SOEs) are under the control of another department composing the State Council. The State-owned Assets Supervision and Administration Commission (hereafter 'SASAC') has responsibilities to guide and push forward the reform and reconstruction of state-owned enterprises, supervise the preservation and increase the value of state-owned assets in the supervised enterprises, appoint and remove the top executives of the supervised enterprises, and grant rewards or inflict punishments on them pursuant to evaluating their performances with legal procedures.⁹⁸ Merger can be a method by which SOEs increase the value of their assets.⁹⁹

MOFCOM under the control of the State Council plays the roles of legislator and enforcer of merger control. It may grant privileges to the merger of SOEs in order to realise the aim of industrial policy. Looking through the history of China, the unfair treatment of SOEs and other kinds of enterprise was a hidden problem for merger control in China.¹⁰⁰

⁹⁷ Names of the 113 SOEs are available at: <http://www.sasac.gov.cn/n1180/n1226/n2425/index.html> (accessed on the 23rd July 2013). These SOEs are scattered in many industries, including energy sources, electric power, transport, mobile communication, aviation, metallurgic and chemical industries and so on. The related antitrust legislation has not confined the scope of industries which enjoy exclusive production and sales. This article blurs the lines of the AML 2008's overview. See also J R Samuels, Tain't What You Do: Effect of China's Proposed Anti-Monopoly Law on State Owned Enterprises, *Penn State International Law Review*, (2007-2008) Volume 26 Issue1, pp.169-202;

⁹⁸ The function of SASAC can be seen at: <http://www.sasac.gov.cn/n2963340/n2963393/2965120.html> (viewed on the 22nd September 2010).

⁹⁹ See '4.1.1 Encouraging Mergers between SOEs between 1978 and 1993' in this chapter.

¹⁰⁰ The links between SOEs and the government also result in the goals' of merger control combining both competition and non-competition factors. See '1.1 Aims of Antitrust Merger Control in China' in this chapter. There are suggestions on solving unfairness between SOEs and other kinds of enterprise, except political revolution. See: B M. Owen *et al.*, China's Competition policy reforms: the anti-monopoly Law and beyond, (2008) volume 75, *Antitrust law Journal*, pp.231-265; J Mitnich and C Yang, A Emch: The Dragon Rises: China's Merger Control Regime One Year On, (2009) Volume 23, *Antitrust*, pp. 53-59.

4.2.2 Enforcement Authority of China's Merger Control

4.2.2.1 The Role of MOFCOM in China's Merger Control System

In China's merger control system MOFCOM is in charge of legislation, review and making final decisions.¹⁰¹ Of the twelve guidelines on antitrust merger control, eight have been issued by MOFCOM. In addition the State Council of China¹⁰² and other administrative departments under the State Council¹⁰³ all joined in the legislation of guidelines. These guidelines all belong to administrative rules.¹⁰⁴

In addition the Anti-monopoly Bureau under MOFCOM is in charge of reviewing mergers, accepting notification and negotiation of concentrations, hearing witnesses, investigating and examining.¹⁰⁵ It makes the final decision based on investigation.

¹⁰¹ In the MOFCOM the Anti-monopoly Bureau (AMB) is responsible for enforcing concrete works of the Anti-monopoly Committee of the State Council. In 2008 the State Council approved the new three fixed program of the MOFCOM (fixing function, fixing formation, fixing jobs). The Bureau is founded through this program. The Program can be seen at: <http://finance.sina.com.cn/roll/20080914/06085304283.shtml> (Viewed on the 5th September 2013).

¹⁰² According to article 85 of The Constitution 1982, the State Council is the Central People's Government of the People's Republic of China, the executive body of the highest organ of state power; and the highest organ of state administration.

¹⁰³ The provision of calculation method on application of concentration in financial operators was issued jointly by the MOFCOM, People's bank of China, China Banking Regulatory Commission, China Securities Regulatory Commission, China Assurance Regulatory Commission on 22 July 2009, which came into force on the 15th August 2009.

¹⁰⁴ The concept of administrative rule can be seen *supra* note 65.

¹⁰⁵ There are nine important functions of Anti-monopoly Bureau under MOFCOM: a. to draft the related regulation on merger control and formulate administrative rules and documents of administrative norms on interpretation of regulation; b. to examine mergers based on anti-monopoly law, accept notification, carry out the work of hearing, investigation and merger review; c. to accept and investigate concentrations which are notified to antitrust enforcement authority, and punish illegal activities; d. to investigate monopoly behaviour in external trade, and take measures to eliminate its issues; e. to guide the responding of internal enterprises on anti-monopoly in foreign countries; f. to initiate and organise negotiation and discussion of competition articles in bilateral or multilateral agreements; g. to organise international communication and cooperation on bilateral or multilateral competitive policies; h. to be responsible for specific assignments by the Anti-monopoly Committee of the State Council; i. to fulfil other assignments specified by the leaders in MOFCOM. See the official site of Anti-monopoly Bureau at : <http://fldj.mofcom.gov.cn/aarticle/gywm/200809/20080905756026.html?1992812441=705144026> (viewed on the 22nd September 2013).

4.2.2.2 Mission of Implementing Non-competitive Considerations

MOFCOM is one of the ministries under the State Council of China.¹⁰⁶ It has to accomplish the assignments entrusted by the State Council.¹⁰⁷ Similarly, the Anti-monopoly Bureau has to accomplish the assignments which are entrusted by the MOFCOM. The truth is that industrial policy which conflicts with the protection of competition has been approved by the State Council. For example, on the 5th December 2006 the State Council transmitted the guidance stipulated by the State-owned Assets Supervision and Administration Commission (Hereafter SASAC). The Guidance concerns the adjustment of state-owned assets and reconstruction of SOEs.¹⁰⁸ It requires the state-owned asset to concentrate in vital industries and key areas to protect their oligopoly of State Assets. Encouragement of oligopoly contradicts the goal of maintaining competition. Such industrial policies may influence the impartial implementation of competition policy by the Anti-monopoly Bureau.

4.2.3 Ineffectiveness of Judicial Review

Pursuant to article 53 of the AML 2008, where any party concerned is dissatisfied with merger decisions, it may first apply for administrative reconsideration; if the party is still dissatisfied with the reconsideration decision, it may lodge an administrative lawsuit according to law. That is to say administrative reconsideration and lawsuit together undertake the responsibility of annulling or correcting faulty merger decisions under the AML 2008.

¹⁰⁶ Ministries and Commissions under the State Council can be seen at: http://english.gov.cn/2005-08/05/content_20741.htm (Viewed on the 5th February 2011).

¹⁰⁷ The missions of the MOFCOM are available to see at: <http://english.mofcom.gov.cn/column/mission2010.shtml> (accessed on the 17th September 2013).

¹⁰⁸ The State Council Document (2006) No.97. The document is available to see in Chinese at: http://www.gov.cn/xxgk/pub/govpublic/mrlm/200803/t20080328_32542.html (accessed on the 17th September 2013).

4.2.3.1 Ineffective Administrative Reconsideration in China

The AML 2008 has been implemented for about six years. There has been no administrative reconsideration of the decisions on merger control, although criticism of case decisions abound.¹⁰⁹ The reasons for this absence are fourfold. First of all there is no specific legislation on the procedure of administrative reconsideration of merger decision. The plaintiff should bring the action according to general Administrative Reconsideration Law (ARL).¹¹⁰ Secondly, the departments making and reconsidering merger decisions both belong to the MOFCOM.¹¹¹ They are under the same control of the minister of MOFCOM who will maintain consistency of decisions in the MOFCOM.¹¹² In addition, as the department of reconsideration is in the system of the State Council, it will not overturn merger decisions involving industrial considerations which may contradict the aim of maintaining market competition.¹¹³ Thirdly is the separation of reconsidering merger decision and making final decision. The staffs who investigate merger decisions have no right to make the final decision. They can only provide recommendations. It is the head of the DTL, who is not involved in the

¹⁰⁹ The defects of published merger decisions will be discussed in chapters 2 to 5.

¹¹⁰ The Administrative Reconsideration Law of the People's Republic of China was adopted at the Ninth Session of the Standing Committee of the Ninth National People's Congress on the 29th April 1999, and came into force on the 1st October 1999. An unofficial English translation is available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=5279&CGid=> (accessed on the 4th October 2013). Apart from bringing an administrative lawsuit the parties can also institute civil proceedings under article 50 of the AML 2008: where any loss was caused by a business operator's monopolistic conduct to other entities and individuals, the business operator shall assume the civil liabilities.

¹¹¹ In the MOFCOM the Administrative Monopoly Bureau (AMB) is to accept and review the applied concentration. Administrative reconsideration of decisions of merger control is undertaken by the Department of Treaty and Law (DTL) in the MOFCOM. Article 14 of the ARL provides that any citizen, legal person, or any organisation that refuses to accept a specific administrative act of a department under the State Council [...], shall apply for administrative reconsideration to the department under the State Council [...] that undertook the specific administrative act. Therefore administrative reconsideration of merger decision shall appeal to the MOFCOM. This was also applied in *Zhengwei Dong v. the MOFCOM*, see *infra* note 100.

¹¹² Pursuant to Article 90 of the Constitution 2004 ministers in charge of ministries or commissions of the State Council are responsible for the work of their respective departments, convene and preside over their ministerial meetings or commission meetings. They discuss and decide important issues in the work of their respective departments. The Constitution, see *supra* note 67.

¹¹³ According to article 89 (3) of the Constitution 2004 the State Council has the function of setting the tasks and responsibilities of the ministries and commissions of the State Council, exercising unified leadership over the work of ministries and commissions and directing all other administrative work of a national character that does not fall within the jurisdiction of the ministries and commissions. The Constitution 2004, see *supra* note 67.

reconsideration and has no legal background, who takes the final decision.¹¹⁴ Finally, even if reconsideration rectifies the errors of a merger decision, its enforcement is not guaranteed. The official documents from superior governments can change the decision of administrative reconsideration which has already been effective. These four reasons explain the weakness of administrative reconsideration and its poor reputation.¹¹⁵

4.2.3.2 Ineffective Administrative Lawsuit in China

Provision for judicial review of merger decisions is set out in the Administrative Procedure Law (APL).¹¹⁶ There has been only one lawsuit on nonfeasance of merger control in the restructuring of the state-owned telecommunications enterprises. The court rejected the lawsuit owing to the plaintiff's lack of standing.¹¹⁷

At present, judicial review is not independent of executive power. The interpretation from the Supreme Court of China provides that the court should respect the demarcation of executive power and judicial review according to the Constitution. When the administrative decisions under the AML 2008 concern the

¹¹⁴ C Lin, Analysing the issues of administrative reconsideration and its judicial reform [论我国行政复议的困境及其司法化改革, Lun Woguo Xingzheng Fuyi de Kunjing jiqi Sifahua Gaige], (December, 2010), *Legislative Affairs of Xiamen Government*, [厦门政府法制, Xiamen Zhengfu Fazhi], the journal is available on the official site of Legislative Affairs Office of the State Council P.R.China at: <http://www.chinalaw.gov.cn/article/xzfy/llyj/201101/20110100333104.shtml> (accessed on the 18th September 2013).

¹¹⁵ Actually, there is little public trust in the impartiality and authority of administrative reconsideration bodies and staff. They are reluctant to make good damage through the approach of administrative reconsideration. Ibid.

¹¹⁶ The Administrative Procedure Law was adopted at the Second Session of the Seventh National People's Congress on the 4th April 1989, and took effect on the 1st October 1990. An official English version is available at <http://en.chinacourt.org/public/detail.php?id=2695>, (Viewed on the 25th August 2013).

¹¹⁷ On the 6th October 2008, two months after the AML 2008 came into force; Zhengwei Dong lodged an administrative lawsuit. He claimed that the MOFCOM did not conduct any review of the restructuring of the telecommunications industry. The court accepted the claim and the MOFCOM responded to the application in writing. The MOFCOM in its defence contended that the application raised by the applicant lacked sufficient facts and evidence, and advising refusal of the request of the applicant. Ultimately the court adopted the advice of the MOFCOM, and did not accept the claim. The plaintiff, Zhengwei Dong recalled that the judges asked him, 'Is there any connection between you and the restructuring among the state-owned telecommunications enterprises?' The plaintiff replied that he was a consumer. The judge claimed that there were 1.3 billion consumers in China. If they were all to institute suits, what should the court do? See: <http://www.ftchinese.com/story/001030134?page=3> (Viewed on the 18th September 2013).

discretion of the executive department, quantitative restriction, important policy orientation and other public interest, the court will not initiate a 'depth judgement'.¹¹⁸ Therefore, in the implementation of judicial review, the judicial power is subordinated to the government. The structure which leads to such a situation is that the courts are just government organs that happen to fulfil judicial functions.¹¹⁹

In conclusion, neither administrative reconsideration nor judicial review is robust enough to make good damages resulting from faulty merger decision under the AML 2008. This point underlines the importance of MOFCOM's taking appropriate decisions on the effects of mergers on market competition. Meanwhile merger decisions should also be transparent in order to prevent MOFCOM from abusing its discretion and discriminating between SOEs and other kinds of enterprise.

¹¹⁸ The superintendent of the administrative front courtyard of the Supreme People's Court answered questions on the implementation of the AML2008 in a press conference. It is available at: http://news.xinhuanet.com/legal/2008-11/03/content_10299026.htm (Viewed on the 30th August 2011).

¹¹⁹ See J Chen et al., *Implementation of law in the People's Republic of China (London-Leiden Series on Law, Administration & Development)*, (Brill, 2002), 58; M U Killion, Post-WTO China and Independent Judicial Review, (2004), Volume 26 No.3, *Houston Journal of International Law*, pp. 507-559.

Chapter 2: the Definition of the Relevant Market

1 Introduction

The birth of the concept of ‘market definition’ took place in the USA. It was used as an analytical tool in merger cases in the late 1940s.¹ Most other jurisdictions have followed this example and incorporated the term ‘relevant market’ in their guidance or case law.² In antitrust assessment it may be interpreted as ‘the smallest set of products that can create a monopoly’. Products in the ‘relevant market’ can increase in price substantially without significant competitive constraints by products outside the market.³ It differs from the concept of ‘economic market’. Companies may, e.g. use the term ‘economic market’ to refer to the area where it sells its products or to refer broadly to the industry or sector where it belongs.⁴ However, for the purpose of competition law, a relevant market comprises goods or services in a specified area and, where appropriate, over an identified period that provide close competitive mutual constraint, like economic substitutes, for instance. It might be wider than the products which companies only sell. Nevertheless, it cannot be said that products outside the relevant definition do not pose any competitive constraint on products within it. Rather, it implies that products within a relevant market should be directly substitutable and impose a sufficiently strong constraint on each other.⁵

¹ G Werden, The History of Antitrust Market Delineation, (1992) Volume 76, *Marquette Law Review*, pp. 123-215; M Oinonen, Modern economic advances in contemporary merger control: an imminent farewell to the market definition?, (2011) Volume 32 Issue 12, *E.C.L.R.*, pp. 629-637.

² There are at least 12 jurisdictions in the world that have adopted the definition of ‘relevant market’ in their antitrust assessments, including the EU and China. See S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, Second Edition, (Sweet & Maxwell, 2002), 88.

³ L Kokkoris, The concept of market definition and the SSNIP test in the merger appraisal, (2005) Volume 26 No.4, *E.C.L.R.*, 209. However, even now scholars believe it is still a concept searching for a definite definition. See A T Kate and G Niels, The relevant market: a concept still in search of a definition, (2009) Volume 5 No.4, *Journal of Competition Law and Economics*, pp. 297-333.

⁴ Paragraph 3, Commission Notice on the definition of relevant market for the purposes of Community competition law (hereinafter Notice on Market Definition) [1997] O.J. C372/5.

⁵ There is still an issue about the extent to which substitution of two products can be taken as effective. See L Wu & S Baker, Applying the market definition guidelines of the European Commission, (1998) Volume 19 No.5, *European Competition Law Review*, 275. A market is worth

A proper definition of ‘relevant market’ is a necessary precondition of any assessment of the effects of a concentration on competition.⁶ Within the relevant market it is possible to take into account systematically ‘all the variables and factors which might affect competition, *inter alia* an analysis of market shares and concentration ratios’.⁷ Within the scope of the relevant market it is possible to determine the market power of a merged entity from market shares or other related considerations.⁸ If the ‘relevant market’ is defined too narrowly, indication of high market shares may lead to a transaction’s becoming subject to merger control restrictions. However, in the absence of market power, concentration would not be capable of harming consumers (this is Type II false negative error). If markets are defined too widely, suppliers which do in fact have significant market power may be under the legal standard of merger control obligation because of the indication of low market shares. Therefore they might be able to make profit in ways that harm consumers, by raising prices or reducing quality, innovation or choice (this is Type I false positive error).

In this chapter two problems will be examined through comparison. Firstly whether a proper scope of the relevant market can be determined according to the method

monopolising if monopolisation permits prices to be profitably increased. For more detail on this notion see S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, 89.

⁶ See Case C-68/94 & 30/95 *France v Commission* [1998] ECR I-1075, paragraph 143; Case T-2/93 *Air France v Commission* [1994] ECR II-323, paragraph 80; See Chapter 2 Worksheet in ICN Merger Working Group: Investigation and Analysis Subgroup, *ICN Merger Guidelines Workbook*, (2006), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc321.pdf> (accessed on the 8th May 2013); Chapter 4 Worksheet-Market Definition in ICN Merger Working Group: Analytical Framework Subgroup, *Project on Merger Guidelines*, (April, 2004), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc488.pdf> (accessed on the 5th June 2013).

⁷ Point 339 in European Commission, Sixteenth Report on Competition Policy (1986). See Case T-342/99 *Airtours plc v Commission*, E.C.R. [2002] II-2585, paragraph 19; Joined Cases C-68/94 and C-30/95 *France and Other v Commission (Kali & Salz)*, E.C.R. [1998] I-1375, paragraph 143. See also S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, 83.

⁸ According to the ICN report ‘market power’ is variously defined in the relevant jurisdictions, but a definition that might be viewed as common to all would be the ability of the merged firm, or of the firms remaining in the market after the merger, profitably to raise prices significantly above (or reduce output significantly below) competitive levels (or otherwise to reduce rivalry). The objective (and challenge) of merger control is to prevent those mergers that do pose such a threat while not impeding those that do not. See Chapter 2, *Project on Merger Guidelines*, ICN Merger Working Group: Analytical Framework Subgroup, April 2004, p 1. Available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc488.pdf> (Accessed on the 1st March 2012).

of merger control in China, and secondly whether legislation and case decisions under AML 2008 show sufficient public transparency regarding the reasoning process of defining ‘relevant market’.⁹ This chapter is divided into three parts: the first looks at approaches to definition in merger control of the EU. Secondly, the method in the jurisdiction of China will be reviewed. Thirdly, pursuant to comparison of the EU and China, this chapter proposes some recommendations on likely future developments for delineating a proper scope of ‘relevant market’ in merger assessment in China, and also on how to make the approach of merger assessment more transparent in legislation and case decisions.

2 Market Definition in the EU

Before 1997 the European Court of Justice and the Court of First Instance stated on a number of occasions that a definition of ‘relevant market’ is required to be applied in Community competition policy.¹⁰ In 1997 the Commission published the Notice on Market Definition.¹¹ This Notice applies to all EU competition rules, including articles 101 and 102 of the TFEU as well as the merger control regulation.¹² Market definition is delineated as a tool to identify the boundaries of competition between firms:

The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining those undertakings’ behaviour and of preventing them from behaving independently of effective pressure.¹³

⁹ The reasons for choosing these two standards have been discussed in ‘1 Research Questions’ in Chapter 1.

¹⁰ See European Commission, Sixteenth Report on Competition Policy, (1986), paragraph 337; Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v EC Commission* [1973] E.C.R. 215, paragraph 247;

¹¹ The Notice on Market Definition, see *supra* note 4. For discussion of the Notice see A Criscuolo, Commission Notice on the definition of relevant market: a change of policy?, (1998) Volume 4, *EU Focus*, pp. 2-4; L Wu and S Baker, Applying the market definition guidelines of the European Commission, (1998) Volume 19 No.5, *European Competition Law Review*, 275.

¹² Paragraph 1, Notice on Market Definition, *supra* note 4.

¹³ Paragraph 2, *ibid.*

In recent years the increasing economic approach to competition policy in the EU has put market definition at the centre of the process of application of EU competition rules.¹⁴

2.1 Factors Considered in Defining the Relevant Product Market¹⁵

The Notice on Market Definition defines a relevant product market as all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and intended use.¹⁶ The scope of relevant product market is defined in three aspects, namely demand substitutability, supply substitutability and potential competition.¹⁷

2.1.1 Demand-side substitution

Demand-side substitution takes place when consumers switch from one product to another when the relative price of the product changes.¹⁸ Such substitution can occur when customers switch to other products, or source their requirements from suppliers elsewhere. Both these situations are likely to make price increases unprofitable. From an economic point of view, for the definition of the relevant market, demand-side substitution constitutes an immediate and effective disciplinary force on the suppliers of a given product, in particular in relation to

¹⁴ Speech of Mario Monti, who was the European Commissioner for Competition Policy, Market Definition as a Cornerstone of EU Competition Policy, (5th October 2001), available at: http://europa.eu/rapid/press-release_SPEECH-01-439_en.pdf (accessed on the 9th June 2013).

¹⁵ Not all the evidence and factors used by the EU in defining 'relevant market' have been adopted by China. Accordingly this thesis focuses on analysing evidence and factors adopted by both the EU and China in legislation and practice.

¹⁶ Paragraph 7, the Notice on Market Definition, *supra* note 4. The concept of relevant product market is also seen in section 6, Form CO Relating to the Notification of A Concentration Pursuant to Regulation (EEC) No 4064/89, (1994), O.J. L377 (hereinafter 'Form CO').

¹⁷ Paragraph 13, the Notice on Market Definition, *supra* note 4. Demand-side substitution and supply-side substitution will be analysed in detail in this chapter. Potential competition will be taken into account in Chapter 5.

¹⁸ See paragraphs 15-19, the Notice on Relevant Market, *supra* note 4.

their pricing decisions.¹⁹ The following section sums up evidence relied on to define demand-side substitution of a relevant product market.

a. Evidence of substitution in the recent past

Such evidence might offer actual examples of substitution between two products. If there was a change of price in the past, the quantitative loss might be an indication of substitutability. In addition, the switch to new products in the past also offers useful information on the substitution relationship.²⁰ However, the fact that switching has taken place in the past may not be reliable evidence that this would occur again.²¹ Similarly, evidence showing that purchasers switched from product A to B does not establish whether purchasers would in the future switch from B to A; in other words, market definition may not be symmetrical.²²

b. Physical characteristics of the product/services and intended use

Analysis of product characteristics and intended use allows the Commission, as a first step, to limit the field of investigation of possible substitutes.²³ The Commission has stated that for two products to form part of the same product market it is necessary but not sufficient that they are functionally interchangeable.²⁴ In certain conditions customers may not regard similar products as adequate substitutions under the SSNIP test.²⁵ The reasons might be switching costs, brand loyalty and so on. In *Procter/Gamble/VP Schickedanz (II)*, the

¹⁹ See paragraph 13, the Notice on Relevant Market, *ibid.* See also Case T-342/99, *Airtours plc v The Commission*, E.C.R. [2002] II-2585, paragraph 45;

²⁰ It is possible precisely to analyse which products have lost sales to the new product in historical switching evidence. These products may then be substituted for the new product.

²¹ See Joint Case T-125 & 127/97 *Coca Cola v Commission*, E.C.R. [2002] II-1773, paragraph 81-82.

²² This is called a 'one-way' market; if product A exerts a close competitive constraint on the price increase of product B, then products A and B should belong to a relevant market. However, the reverse may be not true: when the price of product A increases, the supplier of product B may not be capable of quickly switching to the supply of product A. Therefore when the substitution test is to product A, products A and B should be separated as independent market. See Case COMP/M.3396 *Group4 Flack / Securicor*, [2004] O.J. C 178/03, paragraph 16,

²³ Paragraph 36, Notice on Relevant Market, *supra* note 4.

²⁴ Paragraph 36, Notice on Market Definition, *supra* note 4; see also Alistair Lindsay, *EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 124.

²⁵ The SSNIP test are provided *infra* '2.3 The SSNIP test and its Limitations' of this chapter.

Commission investigated whether tampons and sanitary towels form separate relevant markets or whether they both belong to a wider feminine products market.²⁶ Although they perform the same function, the Commission identified them as different product markets. This is because there are not enough marginal customers who will switch under the SSNIP test, once their established preference or pattern of use had been established. The product characteristics detected are unable to reflect the substitution of marginal customers. However, even if a product is unique in some way, this does not imply that it constitutes a relevant market in itself.²⁷ Bishop proposes an example: in the truck industry, trucks of 5 to 16 tons and those of 16 tons and over are identified as two separate relevant markets. This is because of their different uses, larger trucks being used in long-haul construction and long-distance distribution traffic.²⁸ However, it is also likely that in response to an increase in the price of 18-ton trucks, customers might choose two 9-ton trucks instead. If the number of customers is sufficient to make the SSNIP test unprofitable, these two categories of truck should belong to the same relevant market.

In sum, the question is not whether two items are similar in some way, but whether they act as effective substitutes both in mutually constraining their prices and in meeting the same needs of consumers.²⁹ If two similar products are to be placed in the same market, this is because they are substitutes (perhaps due to their similarity), not merely because they are similar. Conversely, that a product is unique in some way does not imply that it constitutes a relevant market in itself. Its uniqueness must be such that there are no effective substitutes meeting the same purpose, so that a price increase would not be constrained by competition.

c. Quantitative tests

²⁶ Case IV/M.430 *Procter/Gamble/VP Schickedanz (II)*, [1994] O.J. L 354/32.

²⁷ See Alistair Lindsay, *the EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 125.

²⁸ See Case IV/M.4 *Renault/Volvo*, [1990] O.J. C281/2.

²⁹ Report by Europe Economics for the European Commission, DG Competition, *Market Definition in the Media Sector-Economic Issues*, (November, 2002), available at: http://ec.europa.eu/competition/sectors/media/documents/european_economics.pdf (accessed on the 16th February 2013).

Many of the factors employed by the Commission can only reflect whether two kinds of product might be substituted. This paves the way for the Commission's making an assessment. Nevertheless, the result of these factors should be supported by the results of the SSNIP test as well as some empirical evidence. Through quantitative analysis of causation between price series and similarity of price levels and/or their convergence, the Commission can establish past patterns of substitution. These econometric and statistical approaches contain own-price elasticity, cross-price elasticity and critical loss analysis.³⁰ However, it is inappropriate to define the market only by analysis of price evidence. In *Roberts* the General Court (formerly the Court of First Instance) held that consumer choice is influenced by considerations other than price.³¹

d. Consumer preferences

Despite the existence of substitutes at similar prices, consumer loyalty will limit substitution of the product concerned following a price rise. These consumer preferences may be reflected in 'the market studies that the companies conducted in the past and that are used by companies in their own decision-making on pricing of their products and/or marketing actions'.³² The Commission may examine this evidence from the notifying and third parties.

Apart from above, there are other barriers and costs associated with switching demand to potential substitutes.³³ The extent of the product market might be

³⁰ Own-price elasticity of demand for product X is a measure of the responsiveness of demand to the percentage change in its own price. Cross-price elasticity between products X and Y is the responsiveness of demand for product X to percentage change in the price of product Y. Critical loss assesses the sales which would have to be lost in making its hypothetical price increase unprofitable. See The Merger Working Group presented at the 12th Annual Conference of the ICN, *The Role of Economists and Economic Evidence in Merger Analysis*, (2013), available at: <http://internationalcompetitionnetwork.org/uploads/library/doc903.pdf> (accessed on the 13th October 2013).

³¹ The consumption of products may not depend essentially on economic considerations. It may be associated with the provision of services in the consumer's view, or the specific distribution system in the buyer's. In this respect price evidence may not indicate the scope of relevant market. See Case T-25/99, *Colin Arthur Roberts and Valerie Ann Roberts v Commission* [2001] E.C.R page II-01881, paragraphs 39 and 40.

³² Paragraph 41, the Notice on Relevant Market, *supra* note 4. See Case IV/M.469 *MSG Media Service*, O.J. L364/1.

³³ Paragraph 42, *ibid.*

narrowed in the presence of different categories of customers or price discrimination when such the group could be subject to price discrimination.

This will usually be the case when two conditions are met: (i) it is possible to identify clearly which group an individual customer belongs to at the moment of selling the relevant products to him, and (ii) trade among customers or arbitrage by third parties is not feasible.³⁴

Thus the Commission often contacts the main customers and competitors of merging parties, and collects their views on the likely result of the SSNIP analysis.³⁵

2.1.2 Supply-side substitution

In addition to demand-side substitution the relevant product market is also influenced by supply-side substitution. In responding to the increase in relative price of the products, the suppliers of other products may switch production facilities to produce the monopolised collection of products, or suppliers of products outside the given set of areas might enter into the market. The increased level of supply may render the attempt at price increase unprofitable.³⁶

Supply-side substitution has been accepted as a part of market assessment by the Commission on some occasions. In *Continental Can* the Commission stated the disputed merger threatened to eliminate competition in a 'market for light containers for canned meat products', a 'market for light containers for canned seafood', and a 'market for metal closures for the food packing industry, other than crown corks'. The Commission's definition of the relevant market was rejected by the Court because the Commission had failed to consider substitutes on the supply-side. The EUCJ emphasised that in order to support its market definitions the

³⁴ Paragraph 43, *ibid.*

³⁵ Evidence defining markets is generally indicated in the Market Definition Notice. A questionnaire used in collecting evidence was criticised by the notifying party on the grounds that the results were subjective, arbitrary and unreliable, although such criticism was rejected by the Commission. See Case No COMP/M.2187 *CVC / Lenzing*, [2004] O.J. L82/20, paragraph 25.

³⁶ Paragraphs 20-23, the Notice on Relevant Market, *supra* note 4.

Commission needs to explain why producers of other types would not be able to begin producing cans that competed directly against those of Continental Can.³⁷

Although supply-side substitution has long been recognised by the Commission, its application in cases tends to be an after-thought compared with the principle consideration of demand-side substitution in delineating the relevant market. According to the Notice on Market Definition supply-side substitution is only set as a possible factor which might be taken into account in defining market definition. The premise of using supply-side substitution is that 'its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy'.³⁸ This means that:

Suppliers are able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices.³⁹

Supply-side substitution is even excluded in deciding a relevant product market; Forms RS and CO state:

A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer.⁴⁰

After-thought of supply-side substitution is criticised.⁴¹ Neglecting supply-side substitution might make the defined scope of relevant market narrower than the actual situation. Take various qualities of paper, for instance. Paper of different

³⁷ Case 6/72 *Europemballage Corporation and Continental Can Company Inc. v Commission*, E.C.R [1973], 215, paragraph 33. The case was also discussed in Seanshen, *The principles of Market definition under E.C. competition law and enlighten to Chinese legislator*, (2002), available at <http://webcache.googleusercontent.com/search?q=cache:1UjVZPmL09cJ:www.tahota.com:85/lw2e.shtm+&cd=1&hl=zh-CN&ct=clnk&gl=uk> (accessed on the 11th October 2013).

³⁸ Paragraph 20, the Notice on Market Definition, *supra* note 4.

³⁹ Paragraph 20, the Notice on Market Definition, *supra* note 4. See also Mario Monti, *Market Definition as a Cornerstone of EU Competition Policy*, *supra* note 14.

⁴⁰ Section 4 of Form RS (reasoned submission pursuant to Article 4(4) and (5) of Council Regulation (EC) No 139/2004) and Section 6 of Form CO.

⁴¹ See Alistair Lindsay, *the EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 135. C Boeshertz et al., *Big Deal in a Small World*, (spring, 2004), *Competition Policy Newsletter*, pp. 8-15.

standard of quality (from standard writing paper to high-quality paper) may not be substitutes from the perspective of demand-side. However, manufacturers of paper can adjust different qualities of paper at negligible cost and in a short time-frame. In the absence of particular difficulties in distribution paper manufacturers are able to compete for orders of the various quality levels.⁴² Therefore the market share of merging parties based on the relatively narrow definition is bigger than the actual competitive situation.⁴³ Competitive assessment based on indication of market share will lead to a false negative error.

Although neglecting supply-side substitution in defining relevant market may cause problems, the EU still includes its consideration in the subsequent step of anti-competitive assessment.⁴⁴ The reason may lie in its uncertainty and uneasiness. In general, demand-side substitution can be seen as actual competition. Nevertheless, supply-side substitution is potential competition.⁴⁵ In addition to capacity for potential entry, the Commission still needs to determine whether suppliers have incentives to switch, and if such shift is sufficient to make price increase unprofitable.⁴⁶ Despite this, the authorities cannot ignore supply-side substitution in carrying out merger assessment. As a compromise it might be irrelevant at what stage the relevant factors are considered, as long as all the competitive influences facing a firm are analysed.⁴⁷

⁴² Paragraph 22, the Notice on Market Definition, see *supra* note 4. In the case of Culture goods, books for instance, supply side substitution should be divided according to different content.

⁴³ The Commission would not define a separate market for each quality of paper and its respective use. The various qualities of paper are included in the relevant market and their sales added up to estimate total market value and volume. Supply-side substitution is also found in other situations, like different buses designed for specific types of travel service in Case No IV/M. 477 *Mercedes-Benz / Kässbohrer* [1995] O.J. L 211/1, paragraphs 1-29; An example of supply-side substitution is seen in L Wu and S Baker, Applying the market definition guidelines of the European Commission, *supra* note 11, 275.

⁴⁴ According to paragraph 23 of the Notice on Relevant Market, which states that 'when supply-side substitutability would entail the need to adjust significantly existing tangible and intangible assets, additional investments, strategic decisions or time delays, it will not be considered at the stage of market definition'. The Notice on Relevant Market, see *supra* note 4.

⁴⁵ P Crowther, Product market definition in E.C. competition law: the compatibility of legal and economic approaches, (March, 1996), *Journal of Business*, 179.

⁴⁶ Potential entry will be discussed further in *infra* Chapter 5.

⁴⁷ See P Crowther, Product market definition in E.C. competition law: the compatibility of legal and economic approaches, *supra* note 45, 180.

Evidence of supply-side substitution is similar to that of demand-side substitution, including: (i) switching evidence; (ii) trade flows and buying patterns; and (iii) extent of switching cost, like the costs incurred by suppliers in adjusting to the supply of the new product (such as altering the production process, establishing a distribution network, marketing or obtaining a release from existing contractual commitments and so on).⁴⁸

In addition, in *Varta/Bosch* the Commission intended to separate markets upon supply-side consideration, although demand-side assessment suggests a single market.⁴⁹ The point is that either potential demand-side substitution or potential supply-side substitution is able to render the price increase unprofitable. This means that, having considered one form of substitution, consideration of the other can only widen the market, and the market should never be narrowed again.

The Commission does not take account of potential competition when defining relevant market but only at a subsequent stage if required. This is because the potential competition depends on 'specific factors and circumstances related to the conditions of entry'.⁵⁰

2.2 Factors Considered when Defining the Relevant Geographic Market

The geographic market is defined as:

The area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from

⁴⁸ Examples of cases concerning this factor are available in Alistair Lindsay, *the EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 136. This will be further discussed in *infra* chapter 5.

⁴⁹ In *Varta/Bosch* the Commission used differences in conditions of competition to distinguish relevant product markets, although 'the distinction between the two product markets is not mainly based on a difference in the product itself or in the function of the product'. Case IV/M.12 *Varta/Bosch* [1991] O.J. L320/27, point 13. For further analysis see S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, 97.

⁵⁰ Paragraph 24, the Notice on Relevant Market, *supra* note 4.

neighbouring areas because the conditions of competition are appreciably different in those areas.⁵¹

The scope of relevant geographic market is also determined by the combination of demand-side and supply-side substitution.⁵²

Factors in assessing demand-side substitution of geographic market include: (i) past evidence of diversion of orders to other areas;⁵³ (ii) regional differences, often cited by the Commission as a basis for defining a relevant geographic market. Differences are reflected in legal restrictions and capacity constraints including tariffs, national procurement policies, the existence of cross-border import duties, the need to access distribution and marketing infrastructures, environmental protection and technical standards;⁵⁴ (iii) trade flows and buying patterns;⁵⁵ (iv) in the EU, the Commission has used evidence of differences in absolute price levels to define separate geographic markets.⁵⁶ In the development of its case law it has found that even where there are differences in absolute price between two regions, they can form the same part of the geographic market as well, and the relevant market is not necessarily symmetrical;⁵⁷ and (v) transport costs and other transaction costs. If the disparity in transport cost is obvious, it may indicate why trade between these two regions is unfeasible. Nevertheless, the Commission has also accepted that transport costs are not by themselves sufficient to define

⁵¹ Paragraph 8, the Notice on Market Definition, *supra* note 4.

⁵² Paragraph 9, the Notice on Market Definition, *supra* note 4.

⁵³ Paragraph 45, *ibid.*

⁵⁴ Cases regarding such consideration can refer to Alistair Lindsay, *the EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 174.

⁵⁵ Paragraph 49, the Notice on Relevant Market, *supra* note 4.

⁵⁶ See Case No IV/M.315 *Mannesmann / Vallourec / Ilva*, [1994], O.J. L 257/13, paragraph 19.

⁵⁷ One hypothetical example is where the price in region A is 100 GBP and 120 GBP in region B. However, the transport cost between these two areas is 20 GBP. When the price in region A rises by 5 percent to 105 GBP, suppliers in region B will not export their products to region B. When the price in region B rises by 5 percent to 126 GBP, suppliers in region A can make more profit if they export to region B. Therefore, when a market includes area B it should also involve region A although the absolute price of these two areas is not the same. However, region A is still a distinct market. In light of the above issue the Commission investigates whether areas in a geographic market have similar price movement or surveys the demand-substitution of consumers to the relative price changes directly. See S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, pp. 115-117.

national markets.⁵⁸ For example, in *Pilkington-Techint/SIV*, due to the transport cost of a glass manufacturer, a producer in Spain may not compete directly with a producer in Northern Germany. However, as there is competitive linkage between these two, the Commission eventually defined the relevant geographic market as the whole of the Community.⁵⁹ When the relevant geographic market is considered from supply-side substitution, it is relevant to consider evidence of those sellers' business decisions on the prospect of switching to other areas in response to small changes in prices, the cost of transition and so on.⁶⁰

2.3 The SSNIP Test and its Limitations

There is a common approach to defining the relevant market nowadays and it is adopted by most competition jurisdictions worldwide.⁶¹ The test is known as the 'Hypothetical Monopolist Test (HMT)', 'SSNIP test' or the '5-10% test'. The SSNIP test was first proposed in the 1992 Department of Justice merger guidelines. The 1992 Guidelines state:⁶²

A market is defined as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximising firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least

⁵⁸ The impact of transport costs will usually limit the scope of the geographic market for bulky, low-value products; however, a transport disadvantage might also be compensated by a comparative advantage in other costs (labour or raw materials). See paragraph 50, the Notice on Market Definition, *supra* note 4. Case No COMP/M.2502 *Cargill / Cerestar*, [2002], O.J. C 40/05.

⁵⁹ In this case the highest market shares of the plant's production are sold in the Member States where their float glass production is located. However, given the dispersion of the individual float plants and the varying degrees of overlap of the natural supply areas, making the Commission believe the effects can be transmitted from one circle to another, it seems appropriate to consider that the geographical reference market is the Community as a whole. See Case No IV/M.358 *Pilkington-Techint/SIV* [1994] O.J. L 158/24, paragraph 16.

⁶⁰ See paragraph 30, the Notice on Market Definition, *supra* note 4.

⁶¹ The hypothetical monopolist test has been adopted worldwide, including in Australia, Brazil, Bulgaria, Canada, the EFTA, the European Union and Israel. See S Bishop and M Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, 88.

⁶² The test was not new in 1992. It was included in the 1982 US Merger Guidelines and Adelman expressed the core idea in his 1959 article, 'Economic aspects of the Bethlehem opinion' in the *Virginia Law Review*. See note 17 in S Bishop and M Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, 86.

a ‘small but significant and non-transitory’ increase in price, assuming the terms of sale of all other products are held constant.⁶³

The SSNIP test can be defeated (rendered no profit) if consumers switch from one product to other goods or another location (demand-side substitution), or if the supplier of other products, or suppliers present in other locations, commence supply (supply-side substitution). The test is usually applied on the basis of a 5-10% price increase, and non-transparency of price increase is to avoid the consumer’s delaying purchases until the price returns to its previous price. The SSNIP is applied iteratively. If the increase in price by 5-10% is profitable, then only this set of products is defined as the relevant market, and competition between suppliers of these products determines the scope of relevant market. If the increase in price is unprofitable, due to the competitive constraints of other products or suppliers in other locations, then suppliers of other products should also be included in the scope of the relevant market. The process is applied iteratively until the set of products and geographic areas is such that small, permanent increases in relative prices would be profitable.⁶⁴

The Commission also sets the SSNIP test as ‘a speculative experiment’.⁶⁵ The SSNIP test and substitute test provide a conceptual framework within which to conduct the analytical assessment. Any quantitative or qualitative evidence of competitive constraints can be analysed within this framework. Nevertheless, this model has limitations in certain situations.⁶⁶

Firstly, the SSNIP test may not be applied in all circumstances. The test focuses on the response of purchasers and suppliers to a SSNIP applied to the prevailing

⁶³ The Small and Significant and Non-transitory Increase in Price (SSNIP) is usually taken to be either 5 or 10 percent.

⁶⁴ See paragraph 17, the Notice on Market Definition, *supra* note 4.

⁶⁵ Paragraph 15, *ibid.*

⁶⁶ See P Crocioni, The hypothetical monopolist test: what it can and cannot tell you, (2002) Volume 23 No.7, *E.C.L.R.*, pp. 354-362; G Niels, the SSNIP test: some common misconceptions, *Competition Law Journal*, (2004) Volume 3 No.4, pp. 267-276; L Kokkoris, The concept of market definition and the SSNIP test in the merger appraisal, *supra* note 3, pp. 209-214; M B Coate and J H Fischer, A practical guide to the hypothetical monopolist test for market definition, (2008) Volume 4 No.4, *Journal of Competition Law and Economics*, pp. 1031-1063.

market price. However, in certain instances market price is meaningless. In certain industries, price is subject to regulation (rather than being determined freely); or the product is free of charge, or a new product has not been supplied before, or the conduct being considered is alleged predatory pricing.⁶⁷

The second issue is the ‘Cellophane Fallacy’. This issue became known in competition policy analysis after the celebrated Du Pont case.⁶⁸ It has to do with defining a benchmark for the SSNIP test. Since this issue does not arise in the context of merger analysis, even in the presence of pre-existing dominance,⁶⁹ it does not require further analysis here.⁷⁰

The third point which may mislead the final result of SSNIP test is the selection of evidence. The SSNIP test is quantitative. Unless data are sufficient and reliable, the SSNIP test is not enough to prove the scope of the relevant market. This is especially true when evidence just reflects the views of average customers and disguises the position of customers at the margins.⁷¹ That a majority of consumers responds that they would not switch may not mean the relevant market should be narrowed, because there might be enough marginal consumers who would like to switch outside the sample. The mistake of focusing on average or particular

⁶⁷ In principle the ‘SSNIP’ is relevant only with regard to products or services, the price of which are freely determined and not subject to regulation. See Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services (the ‘SMP Guidelines’) [2002] O.J. C165/6, paragraph 42. See also P Roth and V Rose, *European Community Law of Competition*, Sixth Edition, (Oxford University Press, 2008), 257.

⁶⁸ See *United States v. E. I. du Pont de Nemours & Co.* (1956) 351 U.S. 377. This is a decision of the United States Supreme Court concerning the dominant supplier of cellophane.

⁶⁹ Generally, for analysis of merger cases the benchmarked price will be the prevailing market price. See paragraph 19, the Notice on Market Definition, *supra* note 4. This is because in the aspect of merger control it focuses on whether the merger will result in an increase in prices above the prevailing level (or a reduction in quality). It identifies the competitive constraints at prevailing levels.

⁷⁰ Regarding the Cellophane Fallacy discussion, see S Bishop and M Walker, *the Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, pp. 98-104. D J Aron and D E Bernstein, Regulatory policy and the reverse cellophane fallacy, (2010) Volume 6 Issue 4, *Journal of Competition Law & Economics*, pp. 973-994; G J Werden, Market Delineation under the Merger Guidelines: Monopoly Cases and Alternative Approaches, (2000) Volume 16, *Reviews of Industrial Organization*, pp.211-218.

⁷¹ Therefore, a market decision is made based on evidence from the SSNIP test and other considerations. As in Case *Novartis / Alcon*, in analysing the substitution among anti-glaucoma products, results of SSNIP test was concerned in accompany with the considerations of product price, and intended use. See COMP/M.5778 *Novartis / Alcon* [2011] O.J. C20/8, paragraph 88.

customers in defining a relevant market has been called the ‘toothless fallacy’ after the *United Brands Decision*.⁷² In this case bananas were defined as a relevant market separate from those of other fruit because the very young and very old (those without teeth) did not consider other fruit a suitable substitute for bananas.⁷³ However, that there are a number of people for whom no substitutes were available cannot be sufficient reason for defining the relevant market. The question changes to ‘Will enough consumers switch to other fruit in response to a rise in the price of bananas to make the price rise unprofitable?’.⁷⁴ If the convergence between two products is not sufficient to the extent of constraining each other’s price, those two products should be in separate relevant markets. In another case, *Airtours*, one issue was whether holiday packages to short-haul destinations should be separate from the market of holiday packages to long-haul destinations.⁷⁵ The Commission took account of consumer preferences, average flight time, the level of average prices and the limited interchangeability of the aircraft used for each type of destination, and reached a conclusion that those short-haul destinations belonged to a market separate and distinct from that of long-haul packages.⁷⁶ Regarding this decision, the applicants argued that the use of evidence from average customers disguised the position of customers at the margins. The Court accepted the convergence of short and long-haul packages in special circumstances. Nevertheless it denied that this very limited overlap would suffice to constrain prices throughout the short-haul market since ‘the long-haul holidays concerned would not be regarded as effective substitutes -either on price or other grounds -by more than a very small proportion of customers’.⁷⁷ Therefore the SSNIP test should select a proper response from marginal consumers rather

⁷² Case 27/76 *United Brands Company and United Brands Continental BV v Commission of the European Communities*, E.C.R. [1978] II-207.

⁷³ An example of the extent of substitution is seen in L Wu & S Baker, Applying the market definition guidelines of the European Commission, (1998) Volume 19 No.5, *European Competition Law Review*, 276.

⁷⁴ For more detailed analysis see S Bishop and M Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, *supra* note 2, 92.

⁷⁵ Case T-342/99 *Airtours plc v Commission*, E.C.R.[2002] II-2585, paragraphs 17-48.

⁷⁶ *Airtours plc v Commission*, *ibid*, paragraph 25.

⁷⁷ *Ibid*, paragraphs 21 and 34. The Court upheld the Commission’s reasoning and eventually rejected the plea of the applicant which was to define the relevant market comprising all foreign package holidays, including long-haul packages.

than the average consumer. Non-marginal consumers will be protected by the switching action of marginal consumers who make the increase of price unprofitable. The time period of switching might be taken as one year.⁷⁸ In addition, the questionnaire design affects the customer survey results. Most customers are not likely to predict what their response to a hypothetical situation would be if the price range increase or the length of the price rise is not given.⁷⁹

2.4 Experience in Defining Relevant Market

2.4.1 Methods of Collecting Evidence

A relevant market has two dimensions: the product market and the geographic market. The Commission published a clear notice on the procedures it follows when considering market definition. The starting hypothesis for the definition is based on the market definition provided by the notifying parties in a substantial part of Form CO. Parties are asked to define the relevant product and geographic markets and to provide very detailed additional information to allow the Commission to check that definition.⁸⁰ Consumers and competitors may provide information in order to assist the Commission in identifying both product and geographic markets. The Commission may also refer to the categorisation by international organisations.⁸¹ The Commission will make an objective assessment based on such materials.

⁷⁸ Paragraphs 16 and 20, the Notice on Relevant Market, *supra* note 4. The period of three to four years of substitution has been ruled out by the Commission in specific cases. See note 79 in P Roth and V Rose, *European Community Law of Competition*, *supra* note 67, 255.

⁷⁹ P Crowther, Product market definition in E.C. competition law: the compatibility of legal and economic approaches, *supra* note 45, 184.

⁸⁰ Paragraphs 33 and 34, the Notice on Relevant Market, *supra* note 4.

⁸¹ In *Novartis/Alcon* the pharmaceuticals market was subdivided according to the 'Anatomical Therapeutic Chemical' classification ('ATC') which is devised by the European Pharmaceutical Marketing Research Association ('EphMRA') and maintained by EphMRA and International Medical Statistics ('IMS'). See Case COMP/M.5778, *Novartis/Alcon*, [2011] O.J. C20/8, paragraph 9. See also Alistair Lindsay, *EC Merger Regulation: Substantive Issues*, (London, 2006), 134.

2.4.2 Priority of demand-side substitution

It appears that the Commission's assessment of the relevant product market focuses almost exclusively on demand-side substitution. However, analysis shows that a failure to consider supply-side issues will lead to overly narrow relevant product markets.

2.4.3 Limited Application of the SSNIP Test

The SSNIP test is not an exclusive test for market definition. It is 'one way' of determining the relevant market.⁸² The SSNIP has not been applied frequently by the Commission.⁸³ This may be because the Commission is not ready to challenge the limits of the SSNIP test. Without a quantitative test, however, the extent of substitution which can make the SSNIP test unprofitable cannot be precisely measured.

2.4.4 Harmonising Various Approaches to Market Definition

Since the quantitative SSNIP test has limitations, a qualitative assessment is carried out. Within the framework of the substitution test qualitative assessment takes into account all available evidence in order to get the best possible approximation for the SSNIP test. Harmonisation is a multifaceted process under the Notice on Relevant market, subsequent case law and decisional practice.

⁸² Paragraph 15, the Notice on Market Definition, *supra* note 4.

⁸³ From the sample of Phase II merger cases between 1990 and 2001 it was found that the SSNIP test was used in just 4 percent of geographic market definitions and 11 percent of product market definitions. Copenhagen Economics, *the internal market and the relevant geographic market* (2003), available at: http://ec.europa.eu/enterprise/newsroom/cf/getdocument.cfm?doc_id=533 (accessed on the 15th February 2013).

2.4.5 Market Definition Is Not Unique⁸⁴

Market definitions are not independent of the particular competition issue under consideration. The contextual relationship is reflected in two aspects. Firstly, a different market definition might be adopted in different cases even in the same industry. The first reason lies in the different activities in each merger case. For example, markets for glass packaging might generally be national. However, when merging parties' plant shows significant competitive overlap in two regional markets, the geographic market might be defined as cross-border.⁸⁵ The second reason lies in changing market conditions. Market definition is based on analysis of the structure of the market and of competition prevailing at the time the Commission adopts each decision. Changes will occur in the structure of demand or supply, technology and innovation, or legislation. Therefore, faced with a new case, 'the Commission must define the relevant market again and make a fresh analysis of the conditions of competition, which will not necessarily be based on the same considerations as those underlying the previous finding'.⁸⁶ This has been proved by the practice of the Commission.⁸⁷

Secondly, on most occasions the Commission will leave definitions open if, under conceivable alternative market definitions the operation in question does not raise significant concerns at the next stage of competitive assessment.⁸⁸ On the one hand, this is because there are disagreements on the precise definition. Disagreement may arise because of differing views as to the proposed concentration and various ways of considering factors and evidence. In order to

⁸⁴ 'The criteria for defining the relevant market might lead to different results depending on the nature of the competition issue being examined. Examples are seen in point 12, Commission notice on the definition of relevant market for the purpose of community competition, O.J. C372/5.

⁸⁵ See Case COMP/M.3397 *Owens-Illinois / BSN Glasspack* [2004] O.J. C 174/16, paragraphs 24-26.

⁸⁶ See Joint Case T-125 & 127/97, *Coca Cola v Commission*, E.C.R. [2002] II-1773, [2000] 5 C.M.L.R 467, [2000] All ER (EC) 460, paragraphs 81-82.

⁸⁷ Paragraph 12, the Notice on Relevant Market, *supra* note 4. Case No COMP/M.2337 *Nestlé / Ralston Purina*, [2001] O.J.C 239/07, paragraph 21: While it is true that the Commission in two previous decisions indicated that the relevant geographic market for industrial pet food is EEA-wide, a closer examination of the market condition conducted in this case has revealed that the markets remain national in scope.

⁸⁸ This is indicated in its 1997 Notice on the definition of the relevant market; see also paragraph 27, the Notice on Market Definition, *supra* note 4;

reduce the burden on companies to supply information a definition will open when it may have no influence on the final decision of competitive assessment.⁸⁹

2.4.6 Transparency of Factors in Considering Relevant Market

The Commission expects to increase the transparency of its policy and decision-making in the area of competition policy.⁹⁰ With respect to the relevant market, the Commission renders public the procedures which the Commission follows when considering market definition, and indicates the criteria and evidence on which it relies to reach a decision'.⁹¹

At the legislation level the Notice on Market Definition provides guidance for the process of defining the relevant market. It defines the relevant market, substitution principles for market definition and evidence relied on to define the relevant market.

Transparency of case decision here refers to the ability of the public to see and understand the workings of the merger review process of market definition. Evidence collected for defining the market differs in each transaction. Therefore in each case decision the Commission reveals the evidence on which it relies. The reasoning process is introduced below.⁹²

⁸⁹ The definition of 'relevant market' is open in two situations. First of all it will be open when the concentration has no serious effect on competition on any occasion of market definition. It will also be open if serious doubts have been identified, irrespective of the precise 'relevant market definition'. See paragraph 26, the Notice on Market Definition, *supra* note 4.

⁹⁰ Transparency of competitive analysis in a case might comprise three parts, namely how the agencies view the relevant markets, why they believe a particular transaction might violate the Anti-monopoly Laws and proposal of a remedy. This chapter only concerns the transparency in defining 'relevant market'.

⁹¹ Paragraph 4, the Notice on Market Definition, *Ibid*.

⁹² Apart from the Commission's case decision, the judgment of the court in the appeal case also makes its contribution to the development of defining 'relevant market'. As this thesis only discusses the substantive test of merger control, the contribution of the court to the transparency of relevant market definition is not considered here.

3 Market Definition in China

A year after entry into force of the AML 2008 the Anti-monopoly Committee of the State council (AMC)⁹³ published a Guideline on the Definition of Relevant Market (Guideline on Market Definition).⁹⁴ The Guideline clearly identified the definition of relevant market,⁹⁵ its functions⁹⁶ and the basis and general methods of defining the market.⁹⁷ As compared with the EU, which published its formal Notice on Market Definition more than seven years after the European Merger Regulation came into force; the transparency of market definition in China came earlier in the legislation.

Under the Guideline ‘relevant market’ refers to the product scope and geographic scope within which business operators compete for specific products or services during a particular period of time. The Guideline also admits that competition within the relevant market should be the extent to which a product (or geographic area) can be substituted.⁹⁸

The definition of ‘relevant market’ in China’s merger control regime is also a requirement of competitive assessment.

Defining the relevant market in a scientific and reasonable manner plays an important role in key issues such as recognising competitors and potential

⁹³ On 15th June 2011 MOFCOM announced that its Anti-monopoly Bureau would put up a signboard for the "Office of State Council's Anti-Monopoly Commission". (Actually the office of Anti-Monopoly Commission has been in the MOFCOM since the enactment of the AML in 2008). The news is available at: <http://www.chinalawinsight.com/2011/06/articles/corporate/antitrust-competition/formal-establishment-of-antimonopoly-commission-office-within-mofcom-approved/> (accessed on the 23rd January 2013)

⁹⁴ The Guideline was promulgated by the Anti-monopoly Committee of the State council on the 24th May 2009 and took effect on the same day (hereinafter called ‘the Guideline on Relevant Market’). An unofficial English translation is available at: http://www.cuplge.com/info_show.asp?news_id=30705 (accessed on the 23rd January 2012). The official translation is not issued in this thesis.

⁹⁵ Article 3 of the Guideline on Market Definition.

⁹⁶ Article 2, *ibid.*

⁹⁷ Substitution analysis is mentioned in Chapter 2 of the Guideline. It includes demand-side and supply-side substitution, which are similar to the basic principles for market definition revealed in the Notice on Market Definition of EU, *supra* note 4, paragraphs 13 to 23.

⁹⁸ Article 4 of the Guideline on Market Definition, *supra* note 94.

competitors, determining the market share of business operators and the degree of market concentration, deciding the market position of the business operators, analysing the effect of business operators' behavior on market competition, judging whether the business operators' behavior is lawful and the legal liabilities of unlawful conduct. As a result, the relevant market definition is usually the starting point of conducting analysis of competitive behavior and an important step of anti-monopoly law enforcement.⁹⁹

3.1 Factors Considered When Defining the Relevant Product Market

Supply-side substitution is excluded in deciding a relevant product market. The Guideline states:

The relevant product market is a market composed of a group or category of products which is considered by the consumers to be closely substitutable according to the features, use and price of the products. These products are mutually intensively competitive. In antitrust enforcement they may be used as the product scope within which business operators compete.¹⁰⁰

From the perspective of demand-side substitution the relevant product market definition may be considered from the following at least:

- a. Evidence showing consumers switch or consider switching to purchasing other products due to a change in the products' price or other competitive factors.
- b. Products' overall characteristics and uses including their exterior shape, peculiarities, qualities, technical features etc. There may be certain differences between the characteristics; nevertheless, consumers may

⁹⁹ Article 2, *ibid.*

¹⁰⁰ Paragraph 2, article 3, *ibid.* The wording is consistent with its counterpart in EU competition law. See Section 4 of Form RS and Section 6 of Form CO, *supra* note 37.

regard the products as close substitutes given identical or similar uses thereof.

c. Products' price variance. Usually products with a strong substitution relationship share a similar range of prices and present the same trend in price changes. In price analysis, if price changes were not caused by competitive factors, the circumstances should be excluded.

d. Products' distribution channel. Products that have different distribution channels may service different consumers, and it is difficult for such products to compete. Therefore the possibility that such products constitute relevant products is slim.

e. Other important factors. For example consumers' loyalty to specific products; barriers, risks and costs associated with a large number of consumers' switching to substitutes; and differential pricing.¹⁰¹

Similar to the EU Commission, MOFCOM is mainly concerned with demand-side substitution in defining the relevant market. Supply-side substitution is only conducted when it is 'necessary'.¹⁰² From the perspective of supply, the following factors are commonly considered in delineating a relevant product market:

evidence showing other business operators' reactions to changes in competitive factors, such as price; the production process or crafts of other business operators', extent of switching cost like the costs and time needed for producers to adjust the production process, to establish a distribution channel; extra costs and risks in relation to a production switch; the competitiveness of the products supplied after a switch.¹⁰³

¹⁰¹ Article 8, the Guideline on Market Definition, *supra* note 94.

¹⁰² MOFCOM gives no further clarification of the term 'necessary'. See article 7, the Guideline on Market Definition, *supra* note 94.

¹⁰³ Article 8, the Guideline on Market Definition, *supra* note 94.

Different treatment for demand-side and supply-side substitution may cause more serious problems in China's merger control regime than in the EU's. This is because competitive assessment in China mainly concerns market structures. Market share and concentration ratio are important indications of a market structure.¹⁰⁴

Neglecting supply-side substitution will narrow the actual scope of 'relevant market' and lead to false negative merger decisions.¹⁰⁵ As the Guideline states, the contribution of each factor in defining a relevant market is differs according to the circumstances of each case.¹⁰⁶ Therefore the following will examine the definition of 'relevant market' in practice.

By the end of June 2013 nineteen cases of merger control had been published under the AML 2008. In addition to the prohibition *Coca Cola/Huiyuan*, other transactions were cleared with restriction conditions. In the first published case, *Inbev / Anheuser-Busch*, the analysis and definition of 'relevant market' was not mentioned at all before the addition of restrictive conditions. In *Coca Cola/Huiyuan*, 'fruit juice' was defined as a relevant product market; MOFCOM did not reveal any information on the factors on which the decision was based, nor was information provided in *Panasonic/Sanyo* or *Novartis/Alcon*.¹⁰⁷ Since *Mitsubishi Rayon/Lucite*, discussion of the relevant market has been separated, appearing in a section independent of anti-competitive assessment in published decisions. In this case the overlap of industry between merging parties was considered to be the scope of relevant product market.

Business of Mitsubishi and Lucite China mainly overlapped in MAA's manufacturing and distribution. These two companies have a small scope of overlap in producing SpMAs, PMMA particles and PMMA sheet. Therefore the relevant product markets are MMA, SpMAs, PMMA particles and PMMA sheet.

¹⁰⁴ The positions of market share and concentration ratio in China's merger review were analysed in '3.1 Initial Review of Market Shares and Concentration Ratio' in chapter 3.

¹⁰⁵ See *supra* '2.1.2 Supply-side Substitution'.

¹⁰⁶ Article 8, the Guideline on Market Definition, *supra* note 94.

¹⁰⁷ See part 4 of *Novartis/Alcon*. Announcement of MOFCOM (2010) No.53, *Novartis /Alcon*.

Except for MMA this concentration has limited effects on the product market of the other three.¹⁰⁸

The same reasoning appeared in case *Pfizer/Wyeth*.¹⁰⁹ In practice the scope of ‘relevant market’ might be broader than the overlapping product. This is because there are other available alternatives for the overlapping product; the overlapping product and its substitutes should belong to a relevant market. Until recent cases, more reasons for defining a relevant product market were provided. In *Uralkali/Silvinit* the MOFCOM defined potassium chloride as a relevant product market given its unique product feature and purpose which cannot be substituted by other potassic fertilizers or vice versa.¹¹⁰ In *Savio/Penelope*, during the investigation the MOFCOM found that the market of electronic yarn clearers for automatic winders constituted a separate market.¹¹¹ Its function cannot be substituted by other devices.¹¹² Nevertheless, evidence of comparison with other available devices was not published. In *GE/Shenhua*, since coal-water slurry gasification technology differs significantly from that of other coal gasification, requirements for raw coal, feeding method and so on, the licensing market of coal-water slurry gasification technology constituted the relevant product market.¹¹³ In *Seagate/Samsung*, Seagate was in pursuit of sole control of Samsung’s hard disk drive (HDD) business, involving all factories, equipments and assets for R&D, production and sales of HDD. HDD constituted a separate product market as:

¹⁰⁸ See Part 4 of *Mitsubishi Rayon/Lucite*. Announcement MOFCOM [2009] No.28 *Mitsubishi Rayon/Lucite*.

¹⁰⁹ In paragraph 1 of part IV relevant products markets in this transaction are defined as human drugs and animal health products. Products of merging parties overlap in the domestic market of China in: (1) human drugs, including JIC and N6A (2) animal health products, including Mycoplasma Pneumonia of Swine (MPS), Swine Pseudorabies Vaccine (SPV) and Combination Vaccine for Dogs (CVD). Announcement of MOFCOM [2009] No.77, *Pfizer/Wyeth*.

¹¹⁰ Paragraph 2 of Part II, case *Uralkali/Silvinit*. Potassium chloride is primarily used as potassic fertilizer. Potassic fertilizers include at least potassium chloride, potassium sulphate, potassium nitrate, potassium dihydrogen phosphate and potassium magnesium of sulphate. Potassium chloride is generally used as raw material for other forms of potassic fertilizer and compound fertilizer. Announcement of MOFCOM [2011] No.33 *Uralkali/Silvinit*.

¹¹¹ See paragraph 3 of Part II, Announcement MOFCOM [2011] No.73 *Savio/Penelope*.

¹¹² It has the unique function of expeditiously treating yarn defects in an extremely short time; other devices are unable to do so.

¹¹³ Paragraph 3 of Part IV, Announcement MOFCOM [2011] No.74 *GE/Shenhua*.

It differs from solid-state hard drives, flash drive and other secondary storage devices in terms of volume, price, purpose and so on. HDDs are customarily further categorised by reference to their end use including enterprise HDDs, desktop HDDs, mobile HDDs and consumer electronics HDDs.¹¹⁴

Substitution of these four sub-industries was not analysed. Obviously this is an incomplete assessment of the product market. In *Henkel HK/Tian De* products involved in this transaction were ethyl cyanoacetate, cyanoacrylate monomer and cyanoacrylate adhesives. Given their product characteristics, process of manufacture, intended use and other factors, MOFCOM found that ethyl cyanoacetate, cyano acrylate monomer and cyanoacrylate ester adhesives constituted their separate relevant product markets.¹¹⁵

To summarise, in most published decisions a definite product market was defined before competitive assessment. In a few cases MOFCOM offered limited intuitive factors supporting its conclusion, such as product features, intended use, unique function of related industry and evidence of past bidding in the market.¹¹⁶ EU cases have shown that product characteristics and intended use are insufficient to show whether two products are demand substitutes.¹¹⁷ Customers' responsiveness to relative price changes may be determined by other considerations as well. This will depend to a large extent on how customers value different characteristics. Nor it

¹¹⁴ Part II-(A), Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹¹⁵ Paragraph 2 of Part II, Announcement MOFCOM [2012] No.06 *Hankel HK/Tiande*.

¹¹⁶ Section two, part 1, Announcement MOFCOM [2012] No.35 *UTC /Goodrich*. The MOFCOM does not reveal its process of assessment of each factor. For example, in the latest case, *Marubeni/Gavilon*, the relevant product market was China's 'import' market for soybean, corn, bean pulp and dry and course distiller's grains. The MOFCOM based this definition on considerations of the scope and nature of the merging parties and demand and supply substitutability. There is doubt about the substitution of import and local products. However, the MOFCOM does not give further explanation. Hence the decision was criticised as being 'driven by industrial policy considerations and indicates that any transaction that involves key industries-food and agriculture in *Marubeni/Gavilon* – will be scrutinized closely and regulated with an eye toward broader strategic interests'. See H Ha *et al.* (Mayor Brown), the MOFCOM conditionally approves *Marubeni/Gavilon*: competition law and industrial policy in the agricultural sector (8 May 2013), *publications*, available at: <http://www.mayerbrown.com/mofcom-conditionally-approves-marubeni-gavilon-competition-law-and-industrial-policy-in-the-agricultural-sector-05-08-2013/> (accessed on the 7th June 2013).

¹¹⁷ See section b in '2.1.1 Demand-side Substitution' in this chapter.

seems did the MOFCOM consider supply-side substitutes in defining ‘product market’.

3.2 Factors Considered in Defining the Relevant Geographic Market

The relevant geographic market is an area in which consumers can get good substitutes for products. During implementation of the AML 2008 the authority can take this geographic area to be that within which business operators compete.¹¹⁸

In demand-side substitution, factors in deciding geographic market include:

- a. Evidence showing consumers shift to or consider shifting to other geographic areas to purchase products due to change in product price or other competitive factors.
- b. Products’ transport cost and characteristics. Relative to product price, the higher the cost of transport, the smaller the scope of the relevant geographic market is (e.g., in the case of cement); the transport characteristics of products also determine the geographic area of sales (e.g., in the case of industrial gas supplied through pipeline transport).
- c. The actual regions where the majority of consumers choose their products and the product distribution locations of the main business operators.
- d. Trade barriers between geographic areas, such as tariffs, local regulations, environmental factors, technological factors. When the tariff is higher than the price of the products, the relevant geographic market is very likely to be a regional market.
- e. Other important factors. For example consumers’ preference for a particular area or the number of products transported into/out of this geographic area.¹¹⁹

¹¹⁸ Paragraph 3 of Article 3, the Guideline on Market Definition, *supra* note 94.

From the perspective of supply, the following factors are commonly considered in defining the relevant geographic market: evidence showing other business operators' reactions to a competitive factor change such as price; the immediacy and feasibility of supply or distribution of the relevant product by the business operators in other geographic areas (for example costs associated with switching orders to operators in other geographic areas).

In the first two published cases, *Inbev/Anheuser-Busch* and *Coca Cola/Huiyuan*, there was no delineation of the relevant geographic markets. Remedies aimed at reducing adverse effects of mergers on the future competition in China's relevant market.¹²⁰ Xinzhu Zhang and Vanessa Yanhua Zhang thought the geographic market in case *Inbev/Anheuser-Busch* was narrower than that of China. They pointed out that,

Beer is sold to consumers in regional geographic markets through a special distribution system in which the breweries sell beer to distributors, which, in turn, sell to retailers. The distributors' contracts with brewers contain territorial limits and prohibit the distributors from selling beer outside their respective territories. Because the distributors cannot sell a brewer's products outside their territories without violating their contracts with the brewer, brewers can charge different prices in different regions for the same package and brand of beer, and individual distributors (and retailers) cannot defeat such price differences through arbitrage. In other words, due to such contractual arrangements, the relevant geographic beer market should be defined as regional.¹²¹

¹¹⁹ Article 9, the Guideline on Market Definition, *supra* note 94.

¹²⁰ In *Inbev/Anheuser-Busch*, the MOFCOM cleared concentration with commitments in order to 'reduce anti-competitive effects of mergers on China's beer market'. In *Coca cola/Huiyuan*, the MOFCOM stated 'concentration would have negative effect on the effective competition in China's market of fruit juice drinks as well as the market's healthy development'. Announcement of MOFCOM [2008] No.95, *Inbev/Anheuser-Busch*, part III; Announcement MOFCOM [2009] No.22, *Coca cola/Huiyuan*, part IV-(iii).

¹²¹ See X Zhang and V Zhang, *Chinese Merger Control: Patterns and Implications*, (2010) Volume 6 Issue 2, *E.C.L.R.*, pp. 482-486. In addition, administrative protection of local beer producers may be a barrier deterring suppliers in other areas from accessing local market when the price of local products increases. See '4.3.1.1 Barriers of Accessing into Some Administrative Zones' in chapter 1.

Therefore competition conditions might differ in various regional markets. If the geographic market were defined as separate regional markets, anti-competitive concerns might only arise in some regional markets, especially the breweries of Inbev, mainly in southeast China.¹²² Remedies should only target those regional markets that raise competition concerns.

In the following four case decisions, the geographic market was either China¹²³ or global.¹²⁴ In *Novartis/Alco* MOFCOM set out the market share of both merging parties in the global and Chinese markets respectively. However, the competitive assessment only focused on China.¹²⁵ In *Uralkali/Silvini*, competitive assessment revealed that the concentration might have a substantial effect on competition whether in the global market or China's internal market.¹²⁶ Reasons supporting the definition of geographic market have begun to appear since *GE/Shenhua*.

Since the operational scope of the contemplated joint venture post-merger is in China, and domestic buyers of coal water slurry gasification technology only choose its suppliers inside China, the relevant geographic market for this concentration is the China market.¹²⁷

In *Seagate/Samsung* the geographic market for HDDs was global since the procurement and supply of HDDs were on a world-wide basis.¹²⁸ In *Henkel HK/Tiande* historical evidence of the import and export situation was the basis for defining geographic market as global market.¹²⁹

¹²² This is similar to the condition in the EU: when the geographic market is defined as being national in scope, the ensuing anti-competitive assessment will be conducted at national level rather than European.

¹²³ These cases are Announcement MOFCOM [2009] No.28 *Mitsubishi Rayon/Lucite*; Announcement MOFCOM [2009] No.76 *General Motors/Delphi*; Announcement MOFCOM [2009] No.77 *Pfizer/Wyeth*.

¹²⁴ Announcement MOFCOM [2009] No.82 *Panasonic/Sanyo*.

¹²⁵ Announcement MOFCOM [2010] No.53 *Novartis/Alcon*.

¹²⁶ The same situation also exists in the *Savio/Penelope* case. Announcement MOFCOM [2011] No.73 *Savio/Penelope*.

¹²⁷ Paragraph 3 of part II, Announcement MOFCOM [2011] No.74 *GE/Shenhua*.

¹²⁸ Paragraph 2 of part II-(a), Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹²⁹ Announcement MOFCOM [2012] No.06 *Hankel HK/Tiande*.

In conclusion, a definite scope of geographic market was not given in a number of published cases.¹³⁰ Nor did the MOFCOM clarify evidence considered in defining a geographic market.¹³¹ Apart from national and global markets, there are in fact other possible geographic markets in China. Because of administrative monopolies suppliers may not be able easily to switch from one area to another in China.¹³² Thus geographic markets may be narrower than nationwide. On the other hand, where certain products within the Association of Southeast Asian Nations (ASEAN) are free of tariffs, the geographic market may be wider in scope than China.¹³³

3.3 The SSNIP test

The SSNIP test is applied when the market definition is unclear or hard to determine.¹³⁴ However, it has not been applied in any case published by June 2013. The MOFCOM may not be ready to deal with the limits of the SSNIP test.

The Guidelines fixed the benchmark price and the scale of price increase for the SSNIP test.¹³⁵ In addition,

Where substitution reactions are different, tests with different margins of price increases are given to different consumer groups (or geographic areas).

¹³⁰ Of nineteen published cases there are six which offer no clear definition of 'geographic market'. Competitive assessment is focused on the effects of merger national wide in China. Xinzhu Zhang and Vanessa Yanhua Zhang also state that 'it is unclear whether the critical issue of geographic market has been properly addressed by China's antitrust agency'. see X Zhang and V Zhang, Chinese Merger Control: Patterns and Implications, *supra* note 122, 485.

¹³¹ In the latest case, *Marubeni/Gavilon*, the MOFCOM merely outlined factors relied on to delineate geographic market, namely trade flows, consumption habits, transport and imports. The market situation of each factor was not clarified. See paragraph 3, Section 2-2) Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon*.

¹³² The situation of administrative monopoly was introduced in '4.3.1 The Role of Government in Merger Control' in chapter 1.

¹³³ See *infra* case study of *Mitsubishi Rayon/Lucite* in '3.3.3 To What Extent is Sufficiency' in Chapter 5. Announcement MOFCOM [2009] No.28 *Mitsubishi Rayon / Lucite*.

¹³⁴ Article 7, the Guidelines on Market Definition, *supra* note 94.

¹³⁵ Pursuant to Article 11 of the Guideline on Market Definition, the prevailing fully competitive market price is the benchmarked price used in assessing all competition issues, including merger cases. Normally the price increase is on a scale from 5 to 10 percent. However, in legal enforcement the scale of a small price increase may be determined through analysis in light of various different circumstances.

In this case, the relevant market definition shall take into account the specific circumstances of consumer groups and geographic areas.¹³⁶

3.4 Experience in Defining the Relevant Market

In conclusion, China and the EU have a consensus on the method of defining the relevant market, its role in merger assessment and its economic fundamentals. They set the market definition as a premise for further competitive assessment.¹³⁷ The extent of substitution is primarily evaluated from the demand-side (customer-side). Supply-side substitution is considered on conditions.¹³⁸ These similarities are not coincidental. These are prevailing notions shared in international competition law.¹³⁹ Before the entry into force of the AML 2008 antitrust merger control in China was rare.¹⁴⁰ The legislature learnt a lot from foreign jurisdictions including the experience and skills of the EU.¹⁴¹

¹³⁶ Specific circumstances will not be further discussed until different margins of price increases appear in future.

¹³⁷ The OECD confirms that the starting point in any type of competition analysis is the definition of the 'relevant market'. OECD, Glossary of Industrial Organisation Economics and Competition Law, (1990), 54, available at: <http://www.oecd.org/dataoecd/8/61/2376087.pdf> (accessed on the 3rd March 2013).

¹³⁸ Paragraph 20, the Notice on Market Definition, *supra* note 4.

¹³⁹ See *supra* note 62.

¹⁴⁰ For the development of antitrust control of merger in China; see K Li et al., Antitrust control of mergers and acquisitions: a case study of China, *Journal of Business Law*, September (2005), pp. 597-616.

¹⁴¹ See S B Farmer, The Evolution of Chinese Merger Notification Guidelines: a Work in Progress Integrating Global Consensus and Domestic Imperatives, (May 2009), available at: http://works.bepress.com/susan_farmer/1 (accessed on the 19th February 2013). In May 2004, DG Competition agreed terms of reference with the Chinese Government of an EU-China competition policy dialogue. This is a permanent mechanism for consultation and transparency between China and the EU in the competition field, with the aim of enhancing the EU's technical and capacity building assistance to China, which is carried out through the EU-China Trade Project. The dialogue is available at: http://ec.europa.eu/competition/international/bilateral/cn2b_en.pdf (accessed on the 19th February 2013). Key documents and speeches in establishing the bilateral relations are available at: <http://ec.europa.eu/competition/international/bilateral/china.html> (accessed on the 19th February 2013).

4 Discussion and Recommendations

4.1 Methods of Collecting Evidence

In published cases the MOFCOM seeks the views of the relevant government departments, industry associations, competitors and downstream enterprises to determine a relevant market. Views of individual customers are not collected by the MOFCOM.¹⁴² This is in contrast with the EU. When a precise market definition is deemed necessary the Commission will often contact the main customers and companies in the industry to gather their views and evidence on the scope of the relevant market.¹⁴³ The significance of customers' views for the competitive assessment is obvious, since the goal of antitrust merger control is to protect consumer welfare. If customers object to a transaction, this suggests that the concentration is likely to lead to lessening their welfare through higher prices, reduced service quality or a loss of choice or innovation.¹⁴⁴ Although products may have the same characteristics or intended use, there might be many other factors deterring customers from switching under SSNIP, and vice versa. These factors may not be fully considered by the authority. The actual demand-side substitution can be obtained by directly asking customers their response to a SSNIP.¹⁴⁵

¹⁴² Even in the latest case, *Henkel HK/Tiande*, during the review process the MOFCOM only sought opinions from the relevant government departments, industry associations, competitors and downstream enterprises on the definition of relevant market, market structure, industry characteristics and future development trend of the market.

¹⁴³ Paragraph 33, the Notice on Market Definition, *supra* note 4.

¹⁴⁴ There are specific situations in which customers may choose not to object to a merger, even though it is anti-competitive. See Alistair Lindsay, *the EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 545.

¹⁴⁵ G Reynolds and C Walters, The use of customer surveys for market definition and the competitive assessment of horizontal mergers, (2008) Volume 4 No.2, *Journal of Competition Law & Economics*, pp. 411-431; M Hughes and N Beale, Customer surveys in UK merger cases - the art and science of asking the right people the right questions, (2005) Volume 26 No.5, *E.C.L.R.*, pp. 297-303; B Dubow, Understanding consumers: the value of stated preferences in antitrust proceedings, (2003) Volume 24 No.3, *E.C.L.R.*, pp.141-147; Chapter 3: Developing Reliable Evidence in Merger Cases in ICN Investigative Techniques Handbook for Merger Review, (June 2005), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc322.pdf> (accessed on the 28th February 2013).

4.2 The Scope of Possible Substitutes

The overlapping products between merging parties might be narrower than the scope of the relevant product market.¹⁴⁶ Case *Coca Cola/Huiyuan* is an example.¹⁴⁷

On the 18th of September 2008 Coca Cola submitted an application of concentration to MOFCOM. The transaction concerned the acquisition by the wholly-owned subsidiary of Coca Cola Company of sole control of China's Huiyuan Juice with the offer of \$2.4 billion (£1.5 billion). The relevant product market in this transaction was delineated as the market for fruit juice drinks.¹⁴⁸ The MOMCOM believed products of the merging parties were two types of non-alcoholic drink, namely juice and carbonated soft drinks. According to the evidence collected by the MOFCOM, Coca Cola and Huiyuan overlapped in manufacturing juice drinks. Only Coca Cola Company produced carbonated soft drinks; Hui Yuan did not. Given the substitution between juice and carbonated soft drink products was relatively low, they did not belong to a relevant market. Juice products were categorised by reference to the ratio of juice content, including 100% fruit juice, mixed juice with 26-99% fruit juice, and juice with 25% or less fruit juice. The demand-side

¹⁴⁶ G J Stigler and R A Sherwin, the Extent of the Market, (1985) Volume 28, No.3, *Journal of Law and Economics*, pp. 555-585.

¹⁴⁷ Announcement MOFCOM [2009] No.22, *Coca Cola/Huiyuan*.

¹⁴⁸ The *Coca Cola/Huiyuan* case caught the attention of scholars worldwide. There are many articles analysing the case; including the following. There are related articles in English, such as H Zhang, Problems in Following E.U. Competition Law: A Case Study of Coca Cola/Huiyuan, (2011) Volume 3, *Peking University Journal of Legal Studies*, Electronic copy available at: <http://ssrn.com/abstract=1569836> (access on the 3rd March 2013); Q Bu, Coca Cola v. Huiyuan - market-economy driven or protectionism?, *International Review of Intellectual Property and Competition Law*, (2010) Volume 41 No. 2, pp.202-210; related articles in Chinese: J Zhang, Research on the Development of China's Antimonopoly Law in the Case of Coca- Cola Company Acquiring Huiyuan Group, (2010) Volume 11 No. 5, *Journal of University of South China (Social Science Edition)*, pp. 69-71; P Guang, Some Thoughts about the Proposed Acquisition of Huiyuan by Coca Cola from the Perspective of Antimonopoly Law, (2010) Volume 12 No.6, *Journal of Southwest University of Political Science & Law*, pp.42-48; J Sun and M Zhai, Thinking over the Anti-Monopoly Law on China's Foreign Investors' Merger and Acquisition -- taking Coca Cola from America acquired Huiyuan in China as an example, (2009) Volume 37 No.3, *Journal of Xinjiang University (Philosophy, Humanities & Social Sciences)*, pp.45-51;

substitution and supply-side substitution among the three kinds of juice products are relatively high; they comprise a relevant market.¹⁴⁹

However, according to the Report on the Market of Soft Drinks in China, the soft drink industry is comprised of eight kinds of product in China: carbonated soft drinks, fruit juice and juice beverages, vegetable juices, milk beverages, vegetable protein drinks, speciality beverages, bottled water and tea drinks.¹⁵⁰

With the exception of carbonated soft drinks the MOFCOM did not investigate whether customers would switch to the other six kinds of soft drink when the price of juice drink increased. If the substitution between these six kinds of product and juice drinks were all taken into consideration, the final decision on the relevant market might be broader. The following is a simulation of a comprehensive SSNIP test.

a. Demand-side Substitution

(i) Physical characteristics of the product and intended use

All varieties of soft drink have a common use, which is to quench thirst. In addition, these products are particular in function. Bottled water provides some minerals and micronutrients; juices and vegetable drinks contain a lot of vitamins and dietary fibre; milk beverages provide protein. Because of these differences, those subsidiaries are divided into three segments: the first is bottled water (no taste), the second is carbonated soft drinks, and the third is nutritional drinks (including fruit juice and juice beverages, vegetable juice, milk beverages, vegetable protein

¹⁴⁹ The MOFCOM did not define a relevant market in *Coca Cola/Huiyuan*. The above information on the substitution test was revealed in a press conference held by the MOFCOM one week after the decision was published. The MOFCOM stated, 'In the process of defining relevant market, the MOFCOM used economic analysis, and analysed the substitute between juicy and carbonated soft drink, as well as three kinds of juice product with different concentration level'. A report of the Decision of Concentration between Coca Cola and Huiyuan by Press Officer (Yao Qian), Press Office of the MOFCOM, (24th March 2009), available at: <http://bgt.mofcom.gov.cn/aarticle/c/e/200903/20090306123715.html?3428034715=688366810> (accessed on the 20th February 2013).

¹⁵⁰ See National Bureau of Statistics of China, Report on the Market of Soft Drinks in China (the second quarter of 2008), available at: <http://whlg.cei.gov.cn/doc/hyc05/2008082218771.pdf> (accessed on the 3rd March 2013).

drinks, speciality beverages and tea.¹⁵¹ From the perspective of the consumer, carbonated soft drinks may not raise enough competitive constraints on the nutritional drinks in the SSNIP test.¹⁵²

(ii) Product price

The MOFCOM has often inferred that two products are not reasonably substitutable if they are sold at substantially different prices. A related investigation indicates that the prices of fruit juices and juice beverages, vegetable juice, milk beverages and tea drinks are similar.¹⁵³ Their absolute prices are more than two times the absolute price of bottled water. From the disparity in price, bottled water might have no substitute in juice drinks. A critical loss test is used between juice drinks and other potential substitutes in order to find out whether the loss of sales would reduce the profit when the price of juice drinks has a small but significant non-transitory increase. Results reveal that vegetable juice, milk beverages and tea drinks can have a competitive constraint on the price increase of juice drinks. By contrast, carbonated drinks and bottled water cannot impose enough competitive constraint on the price increase of juice drink.¹⁵⁴

(iii) Consumer preferences

Despite the existence of substitutes at similar prices, consumer loyalty may deter substitution following a price rise. However, in the soft drink market evidence shows that consumer preference may not be sufficiently stubborn to deter customers from switching to vegetable juice or tea drinks when the price of juice

¹⁵¹ Ibid.

¹⁵² Increasing numbers of consumers recognise that products of carbonate are rich in sugar and are not much nutritious as juice drink. See Report on the Market in Soft Drink in China (the second quarter of 2008), *ibid.* The MOFCOM also stated that carbonated drinks and juice drinks did not belong to a relevant market. However, evidence supporting the conclusion was undisclosed in the case decision.

¹⁵³ See figure 1 in Xin Hong Jun's Study Studio about Business and industrial economy, Lack of Empirical Analysis in Defining Relevant Market in China—Case Study of Coca Cola/Huiyuan, [论我国相关市场界定实证分析的缺失--以汇源并购案为研究视角, Lun Woguo Xiangguan Shichang Jieding Shizhengfenxi de Queshi—Yi Huiyuan Binggouan Wei Yanjiu Shijiao], (21st March 2011), available at: <http://huiquijiandan.blog.163.com/blog/static/178923061201122142052415/> (accessed on the 20th February 2012).

¹⁵⁴ Ibid.

drinks increases. In the investigation of 2008, 65.5 percent of tea drinkers also drank vegetable juice and juice drinks.¹⁵⁵

b. Supply-side Substitution

There are suppliers who can produce milk beverages and juice drinks at the same time in the commercial market.¹⁵⁶ Owning the technical skill, suppliers have the ability to increase manufacture of juice drinks without incurring significant additional cost or risk in response to price increases.

From the perspective of demand-side substitution, vegetable juice and tea drinks might be involved in the relevant product market as alternatives to juice drinks for customers. From the standpoint of supply-side substitution milk beverages may belong to the relevant product market with juice drinks together. The MOFCOM obviously narrowed the scope of readily available substitutes, and the market power of post-merger enterprises will be exaggerated. If the relevant product market includes juice drinks and vegetable juice, the market share of the merged entity post-merger would only be 20.3 percent.¹⁵⁷ This may be considered not liable to impede effective competition, and presumed to be compatible with the market.¹⁵⁸

¹⁵⁵ See the news, leading position is exchanging between old and fresh brands in China's market in soft drink, (2006), available at: <http://info.china.alibaba.com/news/detail/v0-d5736595.html> (accessed on 21st February 2012).

¹⁵⁶ There are at least two enterprises in the market which sell drinks mixed with juice and milk. (China Mengniu Dairy Company Limited and Hangzhou Wahaha Group Co. Ltd). See Xin Hong Jun's Study Studio about Business and industrial economy, Lack of Empirical Analysis in Defining Relevant Market in China—Case Study about Coca Cola/Huiyuan, *supra* note 154.

¹⁵⁷ Huiyuan has 56.1 percent market share in China's high concentrate juice market. As the demand-side substitution and supply-side substitution between three kinds of juice product with different levels of concentration are relatively high, they are delineated to form the same part of the relevant product market. In the entire juice market Huiyuan's market share is only 10.3 percent, although it is the leading company in the juice market. In owning the brand of 'Mei Zhi Yuan', Coca Cola has the second largest market share (9.7 percent) in the juice market. See Xin Hong Jun's Study Studio about Business and industrial economy, Lack of Empirical Analysis in Defining Relevant Market in China—Case Study about Coca Cola/Huiyuan, *supra* note 154.

¹⁵⁸ Further analysis of competitive assessment will be conducted in chapters 3, 4 and 5.

4.3 Priority of Demand-side Substitution

It appears that the MOFCOM's assessment of the product market depends entirely on demand-side factors. From a procedural perspective there are two advantages to a purely demand-side approach.¹⁵⁹ The first is securing competitive assessment in a relatively short time span. Especially when the market share of merging parties is small, within a defined relevant product market, transactions might have no significant effect on market competition. This is because supply-side substitution can only broaden the scope of the relevant market; the competitive effect will be less significant in a larger market. The antitrust authority might consider supply-side substitution when demand-side substitutions are relatively weak and high market share indicates significant competitive concern.¹⁶⁰ Secondly, involving supply-side substitution enables consistency in case decision. Where supply-side substitutions are excluded at the stage of market definition, further suppliers and products will be considered in the next stage. This means that the market is not delimited correctly in the first place.

In order to make market shares significant and take proper account of competitive constraints, supply-side consideration is best considered at the relevant market stage rather than in the subsequent competitive assessment or neglecting it altogether. The MOFCOM in particular mainly takes market share and concentration ratio as indications of anti-competitive effects of a merger.¹⁶¹ If demand-side substitution is weak or low, competitive concerns arise because the loss of sales may not be enough to countervail the profit of price increase; supply-side substitution should be considered in defining the scope of the market.¹⁶² When

¹⁵⁹ P Crowther, Product market definition in E.C. competition law: the compatibility of legal and economic approaches, *supra* note 45, pp.177-198.

¹⁶⁰ One example is different flavours of carbonated drinks. Demand substitutability between cola and other flavours of drink might be low, but suppliers can add flavours to carbonated drinks at low cost and in the short term. Considering supply-side substitution, different flavours of carbonated drink should belong to the same relevant market. See EU's Case No IV/M.0289 *Pepsico/KAS*, (1992) O.J. C315/2. More examples can be found in P Crowther, *ibid.*, 183.

¹⁶¹ *supra* note 104.

¹⁶² Similarly to the EU, delineating the relevant market in China also starts from the notification form of merging parties. In this form, notifying parties are required to define the relevant market and provide supporting reasons. See part 7.2, the MOFCOM-amended merger notification form. An unofficial

demand-side substitution is sufficient to make the price increase of the merged entity unprofitable, supply-side substitution can be examined at a later stage.

4.4 Limited Application of the SSNIP test

According to the Guideline, the SSNIP test is not the prime method of defining the relevant market.¹⁶³ It has not been used in practice in China. However, without the quantitative test, the extent of substitution between products cannot be precisely measured.¹⁶⁴ Accordingly, if there are sufficient reliable data, it is advisable to reconcile the quantitative and qualitative approaches in defining the market.

If sufficient and reliable data are not available, then a qualitative test is carried out. All available evidence upon which to identify those goods or services that provide a close competitive constraint on one another should be taken into account, in order to provide the best possible approximation for the SSNIP test.

4.5 Development of Factors under Consideration

Chinese legislation sets forth the principles and criteria applied in defining the relevant market, which are similar to those in the Notice of the EU. However, there is disparity in enforcement. In merger control in the EU, product characteristics and intended use are insufficient to show whether two products are demand substitutes. In order to have a comprehensive market definition, a variety of evidence is collected and investigated in each case. In China, although similar factors are listed in the legislation, consideration in practice mostly focuses on product characteristics and intended use. Other factors have not yet been taken into consideration.

translation of the form is available at: <http://www.zhonglun.com/UpFile/File/201206121011281858.pdf> (accessed on the 6th June 2013).

¹⁶³ Article 7, the Guideline on Market Definition, see *supra* note 94.

¹⁶⁴ These econometric and statistical approaches for the substitutive test contain own-price and cross-price elasticity and critical loss analysis. See *supra* note 29.

4.6 Transparency of Case Decisions

General principles and criteria in China's guidelines should be interpreted through administrative practice and case decisions. Although case decisions have no legally binding effect in China, the need for transparency of merger review is universally agreed.¹⁶⁵ There are certain areas where the application of the principles above has to be undertaken with care. This is because there is no an exhaustive list for the assessment of the relevant market. Meanwhile, no single item of evidence can precisely fix the scope of relevant market. The enforcement authority has the discretion to reach a conclusion on relevant market with a subset of the checklist.¹⁶⁶ Transparency of the reasoning process has an important role to play in restraining the discretion of the antitrust authority.¹⁶⁷ Transparency of deliberation on how market definition is determined in case decisions in the EU and China is compared below.

Due to the great worldwide revenues and combined market shares in relevant markets some concentrations have to be reviewed by the anti-monopoly authorities in various jurisdictions including China and Europe. Eleven transactions out of nineteen published merger cases in China were also reviewed by the Commission by the June 2013. In China these eleven transactions were approved with restrictive conditions. In the EU, four of them got outright clearance; seven cases got clearance with commitments.¹⁶⁸ The following analysis is based on those transactions which were reviewed by both the Commission and the MOFCOM.

a. Decisions of outright clearance

In the decision of outright clearance the Commission will issue a brief statement identifying the parties and the nature of the transaction, and discuss the relevant

¹⁶⁵ Discussion of the importance of transparency of merger review is available at '1.3 Transparency of Merger Analysis' in Chapter 1.

¹⁶⁶ On the additional considerations see part V, the Notice on Market Definition; Alistair Lindsay, *The EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), part 3.4 and 3.7,

¹⁶⁷ See *infra* '4.6 Transparency of Case Decision' in this chapter.

¹⁶⁸ Results of merger assessment in the EU and China on the same transactions are presented in the appendix.

product and geographic markets. The statements are often limited in detail but still typically provide the Commission's view of the affected markets, the structure of related industry, the factors considered in analysing the substitution test and the degree of overlap of the participating firms.¹⁶⁹ In China the MOFCOM is not required to publish its reasoning if mergers are cleared without commitment.¹⁷⁰ There is only a public acknowledgement by the agency of the name of the case, the names of the merging parties and the date of approval after assessment.¹⁷¹ Cătălin Ștefan Rusu believed that publishing statements explaining the authorities' reasoning in every transaction would be 'imprudent and tremendously burdensome, and would result in hundreds of cursory opinions that provide little guidance to the public'.¹⁷² The author believes that the extent of clarification on outright clearance decisions in China should at least match that of the EU. This is to prevent the MOFCOM from clearing transactions based on non-competitive considerations, especially since the MOFCOM is under the control of the highest organ of state administration.¹⁷³ Transparency helps the public to scrutinise the enforcement authority's activities.

b. Decisions of prohibition or clearance with commitments

The Commission publishes more details of reasoning in merger cases which are blocked or cleared with commitments. These concentrations often entail in-depth analysis, and take a longer time to evaluate specific factors in transactions. Publishing the complete and in-depth analysis sets a reference for merger parties in future transactions. Consistency and predictability in applying merger norms can

¹⁶⁹ See Case COMP/M.5778 *Novartis/Alcon* [2011] O.J. C20/8.

¹⁷⁰ Article 30, the AML 2008.

¹⁷¹ On 6th January 2013 the MOFCOM published its outright merger cases during the last quarter of 2012 for the first time. Since then, outright cases are published on the MOFCOM's official website at the end of every quarter. Before 2013 there was no information regarding transactions which were cleared outright by the MOFCOM.

¹⁷² See C S Rusu, *A Few Considerations Regarding Transparency and Legal Certainty in European Merger Control*, (2007), *SUBB Jurisprudential*, 185, available at: http://heinonlinebackup.com/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/stubabe3§ion=25 (accessed on the 29th February 2013).

¹⁷³ The role of the MOFCOM in implementing non-competitive considerations has been discussed in '4.3.2.2 Mission of Implementing Non-competitive Considerations' in Chapter 1.

only be checked if there is transparency. This practice also promotes discussion and understanding of the working procedure of competition authorities.¹⁷⁴

An intuitive comparison of transparency in the EU and Chinese systems is reflected in the number of pages devoted to each case decision. The Commission publishes about 50 pages of explanation of its competitive assessment in each case which might be blocked or cleared with commitments. However, in China, the entire case decision is about three to four pages.¹⁷⁵ What information is neglected by the MOFCOM? Does reporting of these decisions contribute to improving transparency? These questions will be answered by comparing case reports in China and the EU.

(i) A preliminary remark on the markets which might be affected by the proposed transaction.

Definition of the relevant market in the EU begins with a preliminary remark on the markets which might be affected by the proposed transaction.¹⁷⁶ Affected products are those which are manufactured by the merger parties.¹⁷⁷

(ii) Confirming products which might substitute for merging parties' overlapping products

After a preliminary remark the Commission gives a general introduction about affected products, including their composition, and how to classify them according to size, use or raw materials. The Commission analyses the substitution among products which are on the same level with the affected products in the structure

¹⁷⁴ See K R Fisher, Transparency in Global Merger Review: A Limited Role for the WTO?, (2006) Volume 11 No.327, *Stanford Journal of Law, Business, and Finance*, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1401204 (accessed on the 3rd March 2012).

¹⁷⁵ In case decisions of *Pfizer/Wyeth*, *Novartis/Alcon* and *Panasonic/Sanyo*, the Commission used 96, 58 and 45 A4 pages respectively to illustrate the process of competitive assessment. See Case COMP/M.5476 *Pfizer/Wyeth* [2009] O.J. C 262/1; Case COMP/M.5421 *Panasonic/Sanyo* [2009] O.J. C322/13; Case COMP/M.5778 *Novartis v. Alcon* [2011] O.J. C20/8. Clarifying competitive assessment of these three transactions in China only took 3, 4 and 3 A4 pages respectively.

¹⁷⁶ Interpretation of 'affected markets' can refer to Section 6 (III) Form CO.

¹⁷⁷ Case COMP/M.5421 *Panasonic/Sanyo* [2009] O.J. C322/13, paragraphs 8-17.

of related products.¹⁷⁸ This is to ensure likely alternatives to affected products can all be included in the substitution test. Affected products might also have sub-segmentations. A substitution test should be conducted among these sub-segmentations to see if affected products should be further divided.

(iii) Evidence of substitution test

In conducting each substitution test the Commission first sets out the views of the parties. In order to reduce anti-competitive concern the merging parties often provide evidence for widening the scope of the market. Their market power could be lessened in a broader market. Accordingly the Commission should check the views of the parties through market investigation. The methods may include giving the SSNIP test to customers and suppliers and obtaining the views of competitors, related experts, industry associations and so on.

(iv) Result of market definition

The Commission will publish its market investigation to all affected markets; some of them have no significant anti-competitive concerns after assessment. In the meantime the Commission can only make a decision on the published reasons.¹⁷⁹ Thus the reasoning processes of the Commission on all affected markets are under public scrutiny.

Unlike these four steps in the EU, MOFCOM's scrutiny of the relevant market is far from transparent; its policy is not clear and predictable.

¹⁷⁸ Information about the structure of related products can be collected through consulting related industry associations or international organisations. For example, in case *Novartis / Alcon* the Commission refers to the 'Anatomical Therapeutic Chemical' classification ('ATC'), devised by the European Pharmaceutical Market Research Association ('EPMRA') and maintained by Eph MRA and Intercontinental medical Statistics ('IMS'). It is the criterion for choosing available substitutes and conducting the substitution test in merger assessment. Case COMP/M.5778 *Novartis / Alcon* [2011] O.J. C20/8.

¹⁷⁹ Article 18 (3) of the EUMR provides that the Commission shall base its decision only on objections on which the parties have been able to submit their observations. As to the Commission, all the reasons which are the basis of the decision should be provided; otherwise, the merging party can appeal the case decision. In the *Air France v. Commission* case concerning the merger of British Airways with Dan Air, one of the pleas of the applicant was that the Commission had failed to discharge its obligation under Article 253 EC to state the reasons upon which its decision was based. The Case T-3/93, *Air France v Commission*, E.C.R. [1994] II-00121.

First of all, on most occasions the MOFCOM only lists markets in which competition would be significantly affected by the proposed transaction.¹⁸⁰ The reasoning process of the MOFCOM on the affected market with no significant competitive concerns is not discernible by the public. This is unlike the EU, which briefly shows the views of the parties and market investigation on all affected markets even with no serious competitive concerns. The advantage of the Commission's policy is obvious. Differing views are expressed, although the authority believes merger would not raise significant anti-competitive effects on certain affected markets. The final decision provides an important opportunity for the enforcement authority to clarify how it has reviewed those different opinions. It also increases predictability in applying merger norms. The MOFCOM should publish and make transparent its reasoning process to all markets affected by the merger.

Secondly, the MOFCOM does not introduce the background of the related industry and the position of the affected product in the structure of industry. For instance, in *Panasonic/Sanyo* three categories of battery are defined as the relevant product market.¹⁸¹ The placement of merging parties' overlapping products in the structure of the battery industry is not clear. The criterion for choosing available substitutes for the overlapping products of merging parties is not disclosed. In *Coca Cola/Huiyuan* it can only be presumed from the following anti-competitive assessment that juice drinks are the relevant product market.¹⁸² The platform for substitution test is unknown.

Thirdly evidence collected from the parties and market investigation remains undisclosed. The MOFCOM publishes general factors it considered in evaluating the relevant market. In *Seagate/Samsung* hard disk drive (HDD) constitutes a separate product market. This is given one sentence of explanation:

¹⁸⁰ In *Panasonic / Sanyo*, MOFCOM only set out the markets in which the Concentration will create or increase significant anti-competitive effects. A similar condition also existed in *Novartis / Alcon*, *GE / Shenhua*. Announcement MOFCOM [2009] No.82 *Panasonic/Sanyo*; Announcement MOFCOM [2010] No.53 *Novartis/Alcon*; Announcement MOFCOM [2011] No.74 *GE/Shenhua*.

¹⁸¹ Ibid.

¹⁸² In *Coca cola / Huiyuan*, the MOFCOM concerns 'after the concentration, Coca Cola will have the ability to leverage its dominant position in the market of carbonated soft drinks to the market of fruit juice drinks'. Therefore it deduces the relevant product market is the fruit juice drink. See Part IV-(1) of *Coca cola/Huiyuan*, Announcement MOFCOM [2009] No.22, *Coca cola/Huiyuan*.

Hard Disk Drives (HDDs) has distinguished disparities with other data storage devices like Solid State Drives (SSDs) and branded External Storage Devices (ESDs) in the aspects of the storage space, prices, and intended use and so on. The MOFCOM defines the HDDs as a separate relevant market.¹⁸³

The MOFCOM further divided products of HDDs into four sub-categories, but the extent of substitution among sub-categories was not discussed. The transparency of MOFCOM's clearance decision with commitments is limited only to the extent of the EU's outright clearance decision.¹⁸⁴ *Seagate/Samsung* got outright clearance in the EU. In order to illustrate the difference between HDDs, SSDs and ESDs, the Commission gave a brief introduction to each product and pointed out the differences of HDDs, SSDs and ESDs in product characteristics, prices and suppliers. In addition the market investigation suggested that there might be separate sub-markets within HDDs based on end-use and form factors, given the limited demand-side substitutability. These sub-categories are: (i) Enterprise or Server HDDs (used in servers and enterprise storage systems), (ii) Desktop HDDs (used in PCs), (iii) Mobile HDDs (used in notebooks); and (iv) Consumer Electronics (used in applications such as digital video recorders or camcorders).¹⁸⁵ Finally, the main effect of the transaction was held to be on the sub-markets for 3.5" desktop hard disk drives and 2.5" mobile hard disk drives.

The MOFCOM only listed differences between products' characteristics, intended use or process of manufacture; the views of the parties and the result of market investigation are absent from the case decision. The parties do not know what information was accepted by the MOFCOM. The public cannot predict the methods or evidence that the MOFCOM will adopt in assessment. The MOFCOM's decision is not under scrutiny to introduce non-competitive considerations, which results in economically adverse effects of an anticompetitive transaction's being allowed, or

¹⁸³ Case *Seagate/Samsung*, Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹⁸⁴ Transaction of *Seagate/Samsung* was approved without commitment in the EU. Case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics*, [2011] O.J. C 165/05.

¹⁸⁵ Case *Seagate/Samsung*, *ibid*.

a healthy, profitable transaction's being blocked.¹⁸⁶ The 'black box' also grants space for rent-seeking. The controversial case of *SEB/Supor* is an example.¹⁸⁷

French home appliances giant SEB International acquired a controlling interest in Supor. With regard to this concentration there was dissent about the relevant product market. Supor insisted that pressure cookers belong to one kind of cooker, and that the relevant product market should be the whole cooker market. Under such a definition, Supor insisted, the sale of cookers in China was 8 to 10 billion RMB in 2005. The sale of Supor was about 700 million RMB. Its market share was less than 10 percent, which would not substantially affect competition in the cooker market. However, if the relevant product market was defined as the pressure cooker market, the effect of concentration would be substantial.

According to the report from China Industrial Information Issuing Centre, Supor's share of the pressure cooker market was 47.05% in 2005, 48.65% in 1999, 52% in 2000 and 53.1% in 2001. If the countryside were included, the market share of Supor would exceed 70 percent.¹⁸⁸ Obviously the effect of concentration on the market depended on whether the scope of the product market was the pressure cooker or all cookers. Eventually the MOFCOM granted outright clearance to the transaction and did not reply to dissenting opinion. Opacity of the merger decision provides opportunity for the merging parties to bribe staff in the enforcement authority.¹⁸⁹

¹⁸⁶ It is doubted whether the decision of the Commission is influenced by national interests. See Q Bu, *Coca Cola v. Huiyuan - market-economy driven or protectionism?*, *International Review of Intellectual Property and Competition Law*, (2010) Volume 41 No. 2, pp. 202-210.

¹⁸⁷ Lyon-based Groupe SEB (EPA:SK), the world's largest manufacturer of countertop kitchen appliances, has reportedly agreed to raise its stake in Zhejiang Supor Co. (SZ:002032), a Hangzhou-based manufacturer of cookware and small electric house ware, from 51.31% to 71.31% to US\$526 million. After a Chinese anti-monopoly investigation Groupe SEB was permitted to increase its 30% stake in Supor to a majority stake in November 2007. However, the MOFCOM's decision of outright approval did not clarify any dissent of the public. The scandal of bribery and lobbying was aroused by the vague case decision. See: http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_csg_ChinaMADigest_022211.pdf (accessed on the 19th September 2013).

¹⁸⁸ The statistic appears in X Wang, *Definition of Relevant Market in Enforcing Antimonopoly Law* [论反垄断法实施中的相关市场界定, *Lun Fanlongduanfa Shishi zhong de Xiangguan Shichang Jieding*], (2008) Volume 1, *Science of Law (Journal of Northwest University of Political Science and Law)*, [法律科学(西北政法学院学报), *Falv Kexue(Xibei Zhengfa Xueyuan Xuebao)*], 125.

¹⁸⁹ According to the investigation of the court Jingyi Guo (a former member of staff of the MOFCOM) accepted a bribe from Supor. The aim of the bribe was to look for support from Guo in order to secure approval of the controversial concentration between SEB and Supor. The same lack of disclosure

The fourth difference from EU practice concerns the outcome of the relevant market. Not all market definitions are precisely delineated. It depends on the particular competition issue under consideration. This has been proved by the Commission.¹⁹⁰ In China the decision on relevant market is fixed. This situation may change when the MOFCOM includes more considerations in its assessment, and increasing disputes are raised. The MOFCOM can learn from the EU, and only fix the definition of ‘relevant market’ when necessary.¹⁹¹ The process begins with a quick ‘virtual market definition’ that identifies candidate problem markets, proceeds to competitive effects analysis and returns to ‘confirmation of market definition’ according to the preliminary remarks of the competitive assessment.¹⁹²

In conclusion, the Notice on Market Definition in the EU generally describes the underlying principles and criteria for market definition and provides a list of factors and evidence on which the authorities rely in defining the ‘relevant market’. In case decision, the Commission interprets how it enforces general factors in the guidelines, and provides precedents for similar transactions in future. In China the Guideline on Market Definition shares the principles and methods of the EU. However, enforcement of the Guideline and transparency of case decisions in China still need improvement in many respects.

also characterised *Coca Cola/ Huiyuan*. Further discussion of this case can be found in ‘4.2 The Scope of Possible Substitutes’ in this chapter.

¹⁹⁰ See ‘2.4.5 Market definition is not unique’ in this chapter.

¹⁹¹ For instance, with respect to the product market, the issue will often be to determine whether products A and B belong to the same product market. The possible relevant market should be confirmed if the inclusion of product B would be enough to remove any competition concerns. See paragraph 26, Notice on Market Definition, *supra* note 94.

¹⁹² The approach was provided by W Blumenthal in Statement before the FTC/DOJ Merger Enforcement Workshop, *Why Bother?: On Market Definition under the Merger Guidelines*, (February, 2004), 5, available at: <http://www.ftc.gov/bc/mergerenforce/presentations/040217blumenthal.pdf> (accessed on the 13th October 2013).

Chapter 3: Horizontal Mergers – Unilateral Effects

1 Introduction

After delineating the relevant market the next step is to assess the anti-competitive effects of a merger.¹ Horizontal mergers produce two related consequences that do not arise in either vertical or conglomerate mergers. They reduce the number of firms active in the relevant market and they result in an increase in market concentration. Thus a horizontal merger may remove important competitive constraints in concentrated markets. The merged group is able profitably to increase price or reduce quality, choice or innovation which is not in the interest of consumers.² Generally, such harm is realised through two channels: (a) by eliminating important competitive constraints on one or more firms, which consequently increases market power, without resorting to coordinated behaviour ('unilateral effects' also called 'non-coordinated effects');³ (b) by changing the nature of competition in such a way that firms that previously did not coordinate their behaviour are now significantly more likely to coordinate and raise prices or otherwise harm effective competition. A merger may also make coordination easier, more stable or more effective for firms which were coordinated prior to

¹ Paragraph 10, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (hereinafter Guidelines on Horizontal Mergers), [2004] O.J. C31/5.

² The reason for evaluating unilateral effects in anti-monopoly assessment can be seen in: M Ivaldi and F Verboven, Quantifying the effects from horizontal mergers in European competition policy, (2005) Volume 23, *International Journal of Industrial Organization*, pp. 669-691; H J Hovenkamp, Harm to Competition under the 2010 Horizontal Merger Guidelines, (2011) Volume 39 Numbers 1-2, *Review of Industrial Organization*, 16; J B Baker, Why did the Antitrust Agencies Embrace Unilateral Effects?, (2003-2004) Volume 12 Issue 1, *George Mason Law Review*; pp. 31-38; R B Starek III and S Stockum, What Makes Mergers Anticompetitive? : 'Unilateral Effects' Analysis Under the 1992 Merger Guidelines, (1994-1995) Volume 63 Issue 3, *Antitrust Law Journal*, 801; J B Baker and C Shapiro, Reinvigorating Horizontal Merger Enforcement, (June 2007), available at: <http://faculty.haas.berkeley.edu/shapiro/mergerpolicy.pdf> (accessed on the 8th May 2013); M Ivaldi et al., The Economics of Unilateral Effects, (November 2003), Interim Report for DG Competition, European Commission, available at: http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_unilateral_effects_en.pdf (accessed on the 8th May 2013);

³ Paragraph 24, Guidelines on Horizontal Mergers, *supra* note 1; the introduction of unilateral effects is also illustrated in Chapter 4 in Worksheet C, ICN Merger Working Group: Investigation and Analysis Subgroup, *ICN Merger Guidelines Workbook*, (2006), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc321.pdf> (accessed on the 8th May 2013).

the merger (co-ordinate effects).⁴ The following is a comparative study of unilateral effects in the EU and China. Coordinated effects will be assessed in chapter 4.

The first criterion determines in which jurisdiction the assessment is better able to reflect the unilateral effects of merger on the competitive process; the second criterion is which jurisdiction has greater public transparency of competitive process. In order to answer these two questions an analysis will be conducted in three steps. Firstly, it attempts to look at the approaches for assessing unilateral effects of horizontal merger in the EU. Secondly, the jurisdiction of China will be reviewed. Thirdly, upon comparison, some recommendations on likely future developments of horizontal merger assessment in China are made.

Recommendations are expected to be proposed in two parts: 1) how to make the result of merger assessment better reflect the effects of a horizontal merger on the competition process; and 2) how to secure the approach of merger assessment in China more transparent to the public through legislation and case reporting.

2 Horizontal Mergers: Evaluating Unilateral Effects in the EU

Article 2(1) of the EUMR contains a non-exhaustive list of considerations which the Commission must take into account when making merger control appraisal, namely:

(a) The need to maintain and develop effective competition within the common market in view of, among other things: the structure of all the markets concerned; and the actual or potential competition from undertakings located either within or without the Community;

(b) The following specific factors: the market position of the undertakings concerned and their economic and financial power; the alternatives

⁴ Paragraph 39, Guidelines on Horizontal Mergers, *supra* note 1; see also Case T-102/96, *Gencor v Commission*, [1999] E.C.R. II-753, paragraph 277; Case T-342/99, *Airtours v Commission*, [2002] E.C.R. II-2585, paragraph 61.

available to suppliers and users; their access to supplies or markets; any legal or other barriers to entry; supply and demand trends for the relevant goods and services, the interests of intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition.⁵

Under the EUMR the Commission published Guidelines on the assessment of horizontal merger.⁶ These identified six principal conditions under which significant unilateral effects are likely to result from a merger. Firstly, that the merging firms have large market shares; secondly, that merging firms are close competitors; thirdly, that customers have limited possibilities of switching suppliers if prices increase; fourthly, that competitors are unlikely to increase supply if prices increase; fifthly, that the merged entity is able to hinder expansion by competitors; and sixthly, that the merger eliminates an important competitive force.⁷ A number of these factors, separately or together, may lead the Commission to conclude that a merger may be likely to harm consumers due to significant unilateral effect.⁸ The following examines how the Commission evaluates each factor to identify unilateral effect.

2.1 Initial Review of Market Share and Concentration Data

The Commission relies on data on market shares and concentration levels as 'useful first indications' of the market structure and the competitive importance of the merging parties and their competitors.⁹ The larger the market share, the

⁵ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (hereinafter 'EUMR'), O.J.L24/1.

⁶ The evaluation of non-coordinated effects in the EU is discussed in: N Horne, *Unilateral Effects and the EC Merger Regulation—How The Commission Had its Cake and Ate it Too*, (2006) Volume 2 Number 1, *Hanse Law Review*, pp.23-43.

⁷ Paragraphs 27-38, Guidelines on Horizontal Mergers, *supra* note 1.

⁸ The Commission states that 'not all of these factors need to be present for unilateral effects to be likely. Nor should this be considered an exhaustive list'. Paragraph 26, Guidelines on Horizontal Mergers, *supra* note 1.

⁹ Paragraph 14, Guidelines on Horizontal Mergers, *supra* note 1. See G J Werden, *Assigning Market Shares*, (2002), Volume 70 Issue 1, *Antitrust Law Journal*, pp. 67-103; Chapter 4 in Worksheet C, ICN Merger Working Group: Investigation and Analysis Subgroup, *supra* note 3; M Ivaldi *et al.*, *The Economics of Unilateral Effects*, *supra* note 2.

greater the competitive constraint. First of all the Commission considers a merger involving a firm whose market share will be 50% or more to be evidence of a dominant market position.¹⁰ Secondly, the Commission has also in several cases considered mergers resulting in firms holding market shares between 40% and 50%.¹¹ Thirdly, in some cases the Commission has considered mergers leading to firms with market shares below 40%.¹² Nevertheless, a high combined market share was found not necessarily to be a good indication of the market power that the proposed merger will obtain as a result of the merger. Market share may only reflect a snapshot of the structure of the relevant market at a given time.¹³ Following the transaction, the merged group will not enjoy market power, notwithstanding its high market share. A market leader which holds a large market share is not dominant where:

- (i) Innovation is taking place at a rapid pace; (ii) there is fierce competition between large players; (iii) entry into a market is easy. Moreover, even a monopolist may be unable to exercise latent market power if it sells durable goods or if it cannot expand sales beyond the monopoly level.¹⁴

By contrast, small market shares may understate the competitive significance of one or more of the merging parties, particularly if the company is coordinating with other rivals, innovating, expanding, cutting prices or generally independent as

¹⁰ The General Court (previously the Court of First Instance) believes that if an undertaking has a particularly high market share and holds it for some time by means of the volume of production and the scale of the supply, this may in itself be evidence of the existence of a dominant position, in particular where the other operators in the market hold only much smaller shares. See note 20, Horizontal Merger Guideline, citing cases T-221/95, *Endemol v Commission*, [1999] E.C.R. II-1299, paragraph 134, and Case T-102/96, *Gencor v Commission*, [1999] E.C.R. II-753, paragraph 205.

¹¹ This may be because merging parties are the No.1 and No. 2 competitors in the market. Meanwhile the market also lacks sizeable competitors constraining the market power of merging parties. See, e.g. Case COMP/M.2337 *Nestle/Ralston Purina*, [2001] O.J.C 239/7, paragraphs 48-50.

¹² For example, the merged entity has competitive advantages in the procurement markets which none of its competitors has. See Case No IV/M.1221, *Rewe/Mein*, [1999] O.J L 274/1, paragraphs 98-114.

¹³ B.12 in Chapter 4, Worksheet C, ICN Merger Working Group: Investigation and Analysis Subgroup, *supra* note 3.

¹⁴ Note 12, L Roller and M Mano, the Impact of the New Substantive Test in European Merger Control, (2006) Volume 2 No.1, *European Competition Journal*, 16.

compared with the rest of the market.¹⁵ Therefore merger assessment today can be less reliant on the rather blunt and imprecise market share test than it was 10 years ago.¹⁶ A number of concentrations with high market share (between 65% and 90%) post-merger have also been cleared by the Commission.¹⁷

Apart from the parameter of market share, the Commission also uses a Herfindahl-Hirschman Index (HHI) to analyse the overall structure of the market, in particular the extent to which a few large firms control supplies or purchases.¹⁸ In addition, the EU establishes a ‘safe harbour’¹⁹ with the HHI index:

The Commission is unlikely to identify horizontal competition concerns in a market with a post-merger HHI below 1,000. Such markets normally do not require extensive analysis.

The Commission is also unlikely to identify horizontal competition concerns in a merger with a post-merger HHI between 1 000 and 2 000 and a delta

¹⁵ See Note 69, A Lindsay, *the EC Merger Regulation: Substantive issues*, Second Edition, (Sweet & Maxwell, 2006), 219. Under the 1989 Merger Regulation a merger was prohibited when it ‘Creates or strengthens a dominant position as a result of which effective competition would be significantly impeded’ (‘dominant’ test). Under the ‘dominant’ test the Commission lacks power to prohibit merger with coordinated effect, while merged entity has no dominant position post-merger. The ‘gap’ issue finally leads the Commission to change its substantive test of merger control from ‘dominant test’ to the ‘SIEC’ test, according to which merger will be declared incompatible with the common market if it presents a ‘significant impediment to effective competition’ (SIEC test). The ‘gap’ issue will be discussed further in chapter 4. The old dominant test can be seen in article 2(2), the 1989 Merger Regulation; the new ‘SIEC’ test can be seen in article 2(2), EUMR.

¹⁶ Commission Green Paper on the Review of Council Regulation (EEC) No.4064/89, 11th December 2001, COM (2001) 745/6 final, 39.

¹⁷ Examples of cases can be seen in note 67, A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 219.

¹⁸ For example, a market containing five firms with market shares of 40%, 20%, 15%, 15% and 10%, respectively, has an HHI of 2,550 ($40^2 + 20^2 + 15^2 + 15^2 + 10^2 = 2\,550$). The HHI ranges from close to zero (in an atomistic market) to 10,000 (in the case of a pure monopoly).

¹⁹ Safe harbour is a scope within which mergers are immune from challenge or are presumed unlikely to be challenged, having a significant anti-competitive effect. See section III. The Use of Safe-Harbours in Chapter 3- Unilateral Effects, the ICN Report on Merger Guidelines, 2004, available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc561.pdf> (accessed on the 20th September 2013).

below 250, or a merger with a post-merger HHI above 2 000 and a delta below 150.²⁰

Unlike a ‘strong safe harbour’ criterion, the ‘soft safe harbour’ is just a presumption within which transactions will not be prohibited.²¹ It can be rebutted in exceptional conditions.²² Although a ‘strong safe harbour’ has more legal certainty than a ‘weak safe harbour’ criterion, the EU still adopts a ‘weak safe harbour’ criterion. This may be based on two considerations. On the one hand the HHI is based on a precise definition of ‘relevant market’. However, market definition is difficult to define accurately due to a lack of exact science. On the other hand transactions with low market share or concentration data will all be cleared under ‘strong safe harbour’ criterion. A false positive error will have no chance of being corrected in the subsequent competitive assessment.²³

²⁰ The approach for calculating HHI level and its increase in concentration has been illustrated in note 19, Guidelines on Horizontal Mergers, *supra* note 1.

²¹ ‘Strong safe harbour’ is a guarantee within which transactions are absolutely immune from challenge by the antitrust authority. Paragraph 36, ICN Merger Working Group: Analytical Framework Subgroup, Project on Merger Guidelines, (April, 2004), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc488.pdf> (accessed on the 8th May 2013).

²² The Commission lists special circumstances such as: ‘(a) a merger involves a potential entrant or a recent entrant with a small market share; (b) one or more merging parties are important innovators in ways not reflected in market shares; (c) there are significant cross-shareholdings among the market participants; (d) one of the merging firms is a maverick firm with a high likelihood of disrupting coordinated conduct; (e) indications of past or on-going coordination, or facilitating practices, are present; (f) one of the merging parties has a pre-merger market share of 50 % or more’. Paragraphs 19-20, Guidelines on Horizontal Mergers, *supra* note 1.

²³ For example, a merger between suppliers of differentiated products may still result in substantial increases in price even if the merged group has relatively low market shares. See ICN Merger Working Group: Analytical Framework Subgroup, *supra* note 3, 6.

2.2 Merging Firms Are Close Competitors²⁴

The reasoning underlying unilateral effects is as follows: as the price of Brand A rises, some customers will shift from Brand A to Brand B. Prior to the merger these customers would be lost to the firm owning Brand A. After the merger this same firm owns Brand B and thus does not lose these customers. As a result the price increase is more profitable to the merged entity.²⁵ Therefore the substitution of merging parties is essential in evaluating unilateral effects.²⁶ If merging parties are seen as the first and second choices by customers, the customers have no other alternative suppliers they can switch to in order to reduce the sale of the merged group and make its price increase unprofitable. Even the market share of the merged group is relatively low; it may still be significantly detrimental to the consumers' interest. By contrast, if the merging parties' products are not regarded by customers as close substitutes, then relatively high market shares post-merger may not be indicative of the increase of market power because customers could switch to other competitors. The loss of sales will make the price increase of the merged entity unprofitable. The analysis merely on the market definition and market shares may cope poorly with different product markets because it neglects the different extent of substitution among products within the same market definition. In order to find out the extent of substitution among products within the same market several sources of information were considered by the

²⁴ Paragraph 28, Guidelines on Horizontal Mergers, *supra* note 1. see also C Shapir, Mergers with Differentiated Product, (1996) *Antitrust*, pp.23-30; G J Werden, Simulating the Effects of Differentiated Products: A Practical Alternative to Structural Merger Policy, (1997) Volume 5 Issue 3, *George Mason Law Review*, pp.363-386; J B Baker and C Shapiro, Reinvigorating Horizontal Merger Enforcement, *supra* note 2; The International Competition Network, ICN Investigative Techniques Handbook for Merger Review, (June 2005), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc322.pdf> (accessed on the 4th June 2013).

²⁵ Chapter 4 Worksheet C, ICN Merger Working Group: Investigation and Analysis Subgroup, *supra* note 3, 39.

²⁶ S Bishop and A Lofaro, Assessing unilateral effects in practice lessons from GE/Instrumentarium, (2005) Volume 26 Issue 4, pp.205-208; G Loriot and F Rouxel (DG Competition, Chief Economist Team), GE/Instrumentarium: a practical example of the use of quantitative analyses in merger control, (Spring 2004), No. 1, *Merger Control*, pp.58-62 available at: http://ec.europa.eu/competition/publications/cpn/2004_1_58.pdf (accessed on the 9th May 2013); M Walker, The potential for significant inaccuracies in merger simulation models, (2005) Volume 1 Issue 3, *Journal of Competition Law and Economics*, pp.473-496; C Shapiro, Mergers with Differentiated Products, *supra* note 26, pp. 23-30; G J Werden, Simulating the Effects of Differentiated Products: A Practical Alternative to Structural Merger Policy, *supra* note 24, pp.363-386.

Commission.²⁷ Firstly, the Commission may request customers to rank the first and second best substitutes to the products they are using currently.²⁸ Secondly, specific evidence like shock analysis and internal documents can also reveal the close relationship between the products of merging parties.²⁹ Thirdly, a bidding study may be used in cases involving tendering markets. The rationale for this exercise was used in *GE/Instrumentarium*:³⁰

If the studies were to show that each merging party offers relatively higher discounts (i.e. lower price) when the other merging party participates in the bid compared to the discount offered in those tenders in which the other party does not participate, this would indicate that the merging parties currently exert an important competitive constraint on one another. This would in turn suggest that the proposed merger may be expected to lead to a post-merger price increase.³¹

Alternatively, if the studies show that the discount offered by the merging parties is largely unaffected by the other merging party, this indicates that the merging parties exert no competitive constraint on each other. Therefore the proposed

²⁷ Kinds of evidence at every stage of merger review include pre-existing documentary evidence, documents created in connection with the merger; descriptive evidence from market participants; written responses to inquiries and compulsory requests for information and expert and quantitative evidence. See Chapter 3, The International Competition Network, ICN Investigative Techniques Handbook for Merger Review, *supra* note 25.

²⁸ *Ibid.*

²⁹ Shock analysis can be used to assess the effects of previous launches of new products or similar significant changes in the operation of the market. See The International Competition Network, ICN Investigative Techniques Handbook for Merger Review, *supra* note 25, 61. More utilisation about this method can be seen in case COMP/M.3191 *Philip Morris/Papastratos*, [2003] O.J. C 258/4, paragraph 27. Internal documents, such as business plans, competitor analysis and marketing studies may reveal the parties' own perceptions of the relative market positions of the different products or the extent to which different rivals' prices are taken into account in determining price. See e.g. Case COMP/M. 2861 *Siemens/Drägewerk /JV* [2003] O.J.L291/1, paragraphs 91-93 and 127-131.

³⁰ See S Bishop and A Lofaro, Assessing unilateral effects in practice lessons from *GE/Instrumentarium*, *supra* note 26, pp.205-208; G Lorient and F Rouxel (DG Competition, Chief Economist Team), *GE/Instrumentarium: a practical example of the use of quantitative analyses in merger control*, *supra* note 26; M Walker, The potential for significant inaccuracies in merger simulation models, *supra* note 26, pp. 473-496.

³¹ See Case COMP.3083 *GE/Instrumentarium*, [2004] O.J. L109/1.

merger would be unlikely to give rise to significant unilateral effects.³² In addition to qualitative investigation, economic techniques can also be employed to assess the profitability of price increase post-merger. In order to determine the actual closeness of competitors the Commission may conduct customer preference surveys, analyse purchasing patterns, estimate the cross-price elasticity of the products involved or use diversion ratio.³³ Regardless, each type of evidence presents different reliability issues.³⁴ Firstly, evidence may not reflect the average customers' appetite if the group being investigated is over- or under-sampled; secondly, competitors of merging parties are likely to focus on the effect of the merger on its own interest rather than the merger's effect on customers or competition. Rivals of merging parties have incentives to favour an anticompetitive merger and oppose an actually pro-competitive merger; thirdly, merging parties want to consummate their transaction, so they will argue that the merger poses little or no competitive risk. Notifying parties may provide selected and screened documents that they expect to be seen by the agency rather than comprehensive materials. Therefore the Commission is advised to supplement some economic analysis with the conclusion from market survey to see if these investigations point to the same conclusion.³⁵

³² Case COMP /M.3687 *Johnson & Johnson/Guidant*, [2006] O.J.L173/16, paragraphs 265, 266, 270 and note 146. Case COMP/M.3436 *Continental/Phoenix*, [2006] O.J.L353/7, paragraphs 121,122 and 135.

³³ Paragraph 29, Guidelines on Horizontal Mergers, *supra* note 1.

³⁴ See chapter 3, The International Competition Network, ICN Investigative Techniques Handbook for Merger Review, *supra* note 25, 37.

³⁵ See A Coscelli and S Baker, the role of market shares in differentiated product markets, (1999) Volume 20 Issue 8, *E.C.L.R.* pp.412-419

2.3 Customers Have Limited Possibilities of Switching Suppliers or Competitors are Unlikely to Increase Supply if Price Increases

If the available alternative suppliers are few or the switching cost is substantial, customers of the merging parties may have difficulty switching to other suppliers.³⁶ These customers may be vulnerable to price increases, particularly where they are engaged in dual sourcing from the merging parties to obtain competitive prices.³⁷

In addition, if the competitors of merging parties are unlikely substantially to increase their output when prices increase, the merging firms may have an incentive to reduce their output and raise their market prices.³⁸ Therefore the Commission will evaluate the likelihood of expanded output by the competitors in three areas, namely the ability, incentive and sufficiency of competitors to expand output.³⁹

2.3.1 Ability to Expand Output

For competitors to be viable alternative suppliers to the merged group they must have the ability to expand, either through existing spare capacity or the ability readily to add new capacity.⁴⁰ The Commission considers the competitive constraint of rivals from three aspects: market share, concentration data and the

³⁶ Paragraph 31, Guidelines on Horizontal Mergers, *supra* note 1. Citing Cases IV/M.877 *Boeing/McDonnell Douglas*, [1997] O.J. L 336/16, paragraph 70; Case IV/M.986 *Agfa Gevaert/DuPont*, [1998] O.J. L 211/ 22, paragraphs 63-71.

³⁷ Lindsay discusses the limited possibilities of switching suppliers in A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, pp.280-283. As the substitution test has been analysed in Chapter 2, it will be discussed in detail here.

³⁸ Paragraph 32-35, Guidelines on Horizontal Mergers, *supra* note 1. Following price increase with merged entity post-merger is distinctive of cartel or tacit collusion, because the strategy does not need any cooperation.

³⁹ See A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, pp. 450-458. The capacity constraint may be broken by either entry or expansion of competitors. Assessment of entry is available in Chapter 5.

⁴⁰ A Lindsay, *ibid.*, 453. See case COMP/M.3178 *Bertelsmann/Springer/JV*, [2006] O.J. L61/17, paragraph 106.

results of any bidding studies.⁴¹ In the Guidelines on Horizontal Mergers the Commission concluded that

Output expansion is, in particular, unlikely when competitors face binding capacity constraints and the expansion of capacity is costly or if existing excess capacity is significantly more costly to operate than capacity currently in use.⁴²

Therefore, unlike in the case of adding new facilities, competitors can increase their production in the very short term without incurring significant costs if they have available spare capacity, overcapacity or excess capacity.⁴³ By contrast, if capacity is constrained, the competitor may not be able to increase production as they are not able to supply more customers in the market in order to capture more market share.⁴⁴

2.3.2 Incentive to Expand Output

Expansion is a lengthy and costly endeavour: it cannot be easily, quickly or inexpensively accomplished.⁴⁵ The sunk costs and costs of advertising may deter rivals from expanding.⁴⁶ If rival suppliers are unlikely to expand production in the short to medium term, then the merged group may have an incentive to reduce its output with the aim of raising prices.⁴⁷ On the basis of EU merger cases Lindsay

⁴¹ A Lindsay, *ibid.*, 450.

⁴² Paragraphs 32 and 34, Guidelines on Horizontal Mergers, *supra* note 1.

⁴³ In *Kali und Salz /Solvay /JV*, although the combined market share of the merged group will be [50-60%] which is more than the second largest competitor (10-20%), the positions of the parties were indicated not give rise to any competition concerns because of the general overcapacity of the competitors and significant buyer power. Case COMP /M.2176, *Kali und Salz /Solvay /JV*, [2002] O.J.C 130/05, paragraph 41.

⁴⁴ For example, in *Mitsui/CVRD/Caemi*, the Commission's investigation indicates that customers could not defeat that price rise of merged group by obtaining larger quantities from other producers. This is due to the high capacity utilisation rate (92%) and no new suppliers were opened during 1999 or 2000. Case COMP/M.2420, *Mitsui/CVRD/Caemi*, [2004] O.J.L92/50, paragraph 183.

⁴⁵ R B Starek III and S Stockum, *supra* note 2, 819.

⁴⁶ Sunk costs are costs which are unrecoverable upon exit from the market. See note 41, Guidelines on Horizontal Mergers, *supra* note 1.

⁴⁷ Paragraph 32, Guidelines on Horizontal Mergers, *supra* note 1. See also Case COMP/M/2187 *CVC/Lenzing* [2004] O.J. L82/20, paragraphs 162 to 170.

concluded that competitors may lack the incentive to expand, particularly in the following circumstances:

Firstly, when the cost structure means that expanding output would not increase their profits: i) their marginal costs of production rise significantly as output increases even though capacity is available; ii) their production facilities are inferior or operate at relatively higher cost; or iii) they lack economies of scale which are available to the merged group.

Secondly, rivals can deploy their assets more profitably for other purposes.

Thirdly, when competitors are precluded from expanding their sales by quota or treaty and therefore have no incentive to compete intensively to gain share.⁴⁸

2.3.3 Sufficiency of Competitors' Increasing Output

If competitors of merging parties have the ability and incentive to expand output, the Commission will consider whether activity by competitors would be sufficient to defeat an attempt by the merged group to exercise market power.⁴⁹ This mostly happens when the fixed costs are high; the merged entity should keep a level of capacity use and can only afford to lose a limited proportion of sales if it wants to increase its profitability by raising prices. In this case competitors would probably be able to defeat any price increase by raising their own sales by at least the same amount.⁵⁰

In addition to expansion of incumbent competitors the price increase of the merged group can also be constrained by the repositioning of potential competitors

⁴⁸ A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 452.

⁴⁹ Paragraph 33, Guidelines on Horizontal Mergers, *supra* note 1.

⁵⁰ In *Bertelsmann /Springer/JV*, the Commission found that printing magazines involved high fixed costs and suppliers generally required as high a level of capacity use as possible. This meant that the merged group could only afford to lose a limited proportion of sales if it wanted to increase its profitability by raising prices. See case COMP/M.3178, *Bertelsmann /Springer/JV*, [2006] O.J. L61/17, paragraph 139.

from neighbouring markets or neighbouring products. Neglecting the potential entry will lead to false negative errors.⁵¹

2.4 Merged Entity Able to Hinder Expansion by Competitors

Some proposed mergers would, if allowed to proceed, substantially impede effective competition by leaving the merged firm in a position where it would have the ability and incentive to make the expansion of smaller firms and potential competitors more difficult or otherwise restrict the ability of rival firms to compete. Their channels contain control of supply of input or distribution possibilities, intellectual property rights and, in some cases, interoperability between infrastructures.⁵² In making this assessment the Commission may take into account, inter alia, the financial strength of the merged entity relative to its rivals.⁵³ With the advantages in the above aspects over competitors the merged entity may be able to raise the costs or decrease the quality of service of its rivals.

First of all a merger may increase the merged group's ability and incentive to influence the input and distribution which makes the expansion or entry of rival firms more costly.⁵⁴ The reduction in the intensity of competition in the upstream market will indirectly influence the merged group's consumer welfare. The elimination or marginalisation approaches include the circumstance where: 1) merger combines the procumbent volumes of two merging parties, and the merged entity could ask for more favourable buying conditions from its suppliers.⁵⁵ As the

⁵¹ Potential entry will be analysed further in Chapter 5.

⁵² Paragraph 36, Guidelines on Horizontal Mergers, *supra* note 1.

⁵³ *Ibid*, citing case Case T-156/98 *RJB Mining v Commission*, [2001] *E.C.R II*-337.

⁵⁴ *Ibid*. The implications of the buying side impact of mergers and the approach of merger analysis can be seen in: J B Nordemann, Buying power and sophisticated buyers in merger control law: the need for a more sophisticated approach, (1995) Volume 16 No.5, *E.C.L.R.*, pp.270-281; P C Carstensen, the Buyer Power and Merger Analysis–The Need for Different Metrics, (February 17, 2004), available to see at: <http://www3.ftc.gov/bc/mergerenforce/presentations/040217carstensen.pdf> (accessed on the 8th May 2013); M L Steptoe, the Power-Buyer Defence in Merger Cases, (1992-1993) Volume 61 Issue 2, *Antitrust Law Journal*, pp.493-504; A Lofaro and S Baker, Buyer power and the Enso/Stora decision, (2000) Volume 21 No.3, *E.C.L.R.*, pp.187-190. R Clarke *et al*. *Buyer Power and Competition in European Food Retailing*, (Edward Elgar Publishing Ltd, 2002).

⁵⁵ See P C Carstensen, the Buyer Power and Merger Analysis–The Need for Different Metrics, *ibid.*, 9.

cost of input is lower than that of the other competitor, the merged entity has greater opportunity than competitors to drive down its product price. Customers may benefit in the short term. However, as competitors are edged out in competition, the merged entity would secure an individual dominant position in the distribution or procurement market. In the long run the merged group with a dominant position can raise prices without the restraint of other rivals. Customers will not be able to switch, as few alternatives are left in the market;⁵⁶ 2) when the loss of a contract to supply the merged group would result in the supplier's risking insolvency (the *thread point*), the merged group would enjoy excessive buyer power.⁵⁷ Therefore the downstream merged entity is able to coerce upstream suppliers into adopting practices that exclude or impose serious competitive disadvantages on rivals.⁵⁸

In the EU the creation or strengthening of market power in a procurement market is considered a competitive harm', and is a possible reason to object a concentration. However, according to paragraph 62 of the Guidelines on Horizontal Mergers, 'if increased buyer power lowers input costs without restricting downstream competition or total output, then a proportion of these cost reductions are likely to be passed on to consumers in the form of lower prices'. Therefore the concerns are when the increased buyer power of the merged entity is not likely to impair competition in the downstream market to which merging parties belong.

In determining the influence of a merger on the supply-side market the Commission considers market competition in three types of market, namely the procurement market, downstream market and buyers of the merged entity:⁵⁹

⁵⁶ The 'spiral effect' was identified by the Commission in *Rewe/Meinl*. See the Case IV/M.1221 *Rewe/Meinl*, [1999] O.J.L274/1, paragraphs 71-74. A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 371.

⁵⁷ Case COMP/M.1684 *Carrefour/Promodès*, [2000] O.J. C 164/5, Paragraph 61.

⁵⁸ See P C Carstensen, the Buyer Power and Merger Analysis–The Need for Different Metrics, *supra* note 55, 12.

⁵⁹ A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 368.

Firstly, the Commission will evaluate whether the merger results in a substantial enhancement in buyer power. In particular, whether there are substantial overlaps in the goods purchased by the merging parties and whether post-merger joint purchasing would be practicable;

Secondly, the structure of buying markets plays a very significant role in both creating incentives for and the opportunity to exploit buyer power.⁶⁰ If upstream suppliers are a ‘must have brand’, this can counterbalance the merged group’s buyer power;⁶¹ if supply is elastic, changes in quantities purchased have no effect on price because suppliers can, without cost, redirect their efforts to producing other products.⁶²

Thirdly, competitors in the downstream market can seek to negotiate terms of supply comparable with those enjoyed by the merged group, whether alone or through joint purchasing schemes. Buyer power can only be exercised if the buyer or buyers in question represent a substantial proportion of purchase in the market.⁶³ In this case purchasing schemes of competitors may be not big enough to countervail the merged entity’s purchase order.

Fourthly, buyer power can only be exercised in the long run if there are barriers to entry into the buyer’s market. Otherwise the profits of monopsony will be eroded by new entry.⁶⁴

⁶⁰ See P C Carstensen, the Buyer Power and Merger Analysis–The Need for Different Metrics, *supra* note 55, 1.

⁶¹ In *Promodes/Casino* the transaction was approved on the grounds that suppliers were often of significant size, some supplied ‘must have’ brands (conferring power on them); the suppliers had numerous other substantial customers (in particular the other buyer collectives) in addition to the merged group, and there was no evidence that the merged group’s buyer power would prove detrimental to the final customer. Case IV/M.991 *Promodes/Casino*, [1997] O.J. C376/11, paragraph 47. Similarly in *Intermarche/Spar*, the Commission allowed the merger although it would enhance buyer power. This is because the upstream suppliers were essentially international-scale producers of ‘Eurobrand’ products which would have sufficient power to counterbalance the merged group’s buyer power. See Case IV/M.946 *Intermarche/Spar*, [1997] O.J. C227/04, paragraph 15; the above two cases are quoted from A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 370.

⁶² A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 367.

⁶³ *Ibid.*

⁶⁴ See COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3, paragraph 583.

2.5 Merger eliminates an important competitive force (sometimes referred to as a ‘maverick’)

Merging firms have no significant market share; nevertheless, they can constrain the competitive process substantially if they are a recent entrant or innovative.⁶⁵ In future they might play the role of a ‘maverick’ in a concentrated market.⁶⁶ A merger involving such a firm may change the competitive dynamic in a significant, anti-competitive way, in particular when the market is already concentrated.⁶⁷ A non-dominant firm acquiring control over a small innovative rival will prevent or delay the introduction of a new product and soften competition in the market.⁶⁸ The Commission will evaluate a recent entrant as the loss of potential competition.⁶⁹ However, innovation markets are usually dependent on a large number of uncertain parameters and therefore often do not justify regulatory intervention.⁷⁰ Therefore there is no special approach for dealing with mergers in high innovation markets in the EU.⁷¹ When the Commission finds some specific characteristics of high innovation markets it will place less emphasis on the prevailing market shares and more on barriers to entry and dynamic effect, such as

⁶⁵ Paragraphs 37 and 38, Guidelines on Horizontal Mergers, *supra* note 1.

⁶⁶ See OECD, Merger Review in Emerging High Innovation Markets, DAF/COMP(2002) 20, 8; R W Davis, Innovation Markets and Merger Enforcement: Current Practice in Perspective, (2003) Volume 71 Issue 2, *Antitrust Law Journal*, pp. 677-704.

⁶⁷ Note 53, Guidelines on Horizontal Mergers, *supra* note 1. Citing Case COMP/M.2568 *Haniel/Ytong*, [2003] O.J. L111/1, paragraph 126.

⁶⁸ L Roller and M Mano, the Impact of the New Substantive Test in European Merger Control, *supra* note 14, pp.20-21.

⁶⁹ The Commission clarifies that, ‘for a merger with a potential competitor to have significant anti-competitive effects, two basic conditions must be fulfilled. First, the potential competitor must already exert a significant constraining influence or there must be a significant likelihood that it would grow into an effective competitive force. Evidence that a potential competitor has plans to enter a market in a significant way could help the Commission to reach such a conclusion. Second, there must not be a sufficient number of other potential competitors which could maintain sufficient competitive pressure after the merger’. See Case IV/M.877 *Boeing/McDonnell Douglas*, [1997] O.J. L 336/16, paragraph 60. Market entry will be further evaluated in Chapter 5 of the thesis.

⁷⁰ It is hard to define an innovation market precisely. The OECD points out some prominent characteristics of innovation intensive markets: high R&D intensity and dependence on intellectual property rights (IPRs) coupled with a closely related heavy reliance on human rather than physical capital; a high degree of technical complexity; rapid technological change and short product cycles; increasing returns to scale; important network effects (in which buyers are the better off the more buyers there are); and significant compatibility and standards issues. OECD, Merger Review in Emerging High Innovation Markets, DAF/COMP(2002) 20, 7.

⁷¹ OECD, *ibid.*

the likelihood of vertical integration or market foreclosure effects caused by the merged entity's advantage in human capacity or IP rights.⁷²

To sum up, in the development of merger assessment in the EU assessment of anti-competitive concerns of a merger is moving from reliance on market structure to a more effects-based approach.⁷³ The trend is firstly reflected in the introduction of a new substantive test. One interpretation of the old substantive test in the EU is that the dominant position of a merged entity is a necessary and sufficient condition to prohibiting a merger or raising significant concerns.⁷⁴ It was argued that the old 'dominant' test would lead to false negative errors, as some transactions raise serious anti-competitive concerns even in the absence of dominance.⁷⁵ For instance, where merging parties are not closest substitutes to customers; where merger between the second and third largest producers in the market which does not create or strengthen the paramount firm in the market; merger creates the likelihood of coordination between the oligopolists or make coordination easier; customer foreclosure will result from vertical or conglomerate mergers;⁷⁶ a merger eliminates potential competition,⁷⁷ or controls of entry barriers.⁷⁸

⁷² Remedies for eliminating anti-competitive concerns in innovation market are to lower entry barriers rather than classical divestiture. J T Lang, *European Community Antitrust Law: Innovation Markets and High Technology Industries*, (1997), Volume 20 Issue 3, *Fordham International Law Journal*, pp.717-818; T B Marcotullio, *Battle Against Drug-Makers: An Analysis of European Union and United States Merger Enforcement in the Pharmaceutical Industry 1995–1999*, (2001) Volume 32 Issue 2, *Law and Policy in International Business*, pp.449-486.

⁷³ L Roeller and O Stehmann, *The year 2005 at DG competition: The trend towards a more effects-based approach*, (2006) Volume 29 Issue 4, *Review of Industrial Organization*, pp.281-304.

⁷⁴ Under the 1989 Merger Regulation a merger was prohibited when it tended to 'create or strengthen a dominant position' as a result of which effective competition would be significantly impeded'.

⁷⁵ Under the old substantive test the Commission had no right to prohibit an anti-competitive merger if it has no single dominant position. The Commission tried two approaches to solve the 'gap' issue. The first approach was to stretch the concept of dominance to reach all significant anticompetitive effects from mergers which would have divorced the concept from the plain meaning of the word 'dominance'. This created a serious risk of excessive enforcement under Article 102. The other approach was to reword a new substantive test in the EUMR which widened the scope for intervention of non-coordinated effects. The 'gap' issue will be further discussed in Chapter 4.

⁷⁶ Vertical and conglomerate situations will not be further discussed here. Vertical integration can considerably harm consumer welfare even if none of the merging firms is *pre se* dominant in their respective markets. For instance, if an upstream undertaking merges with a downstream undertaking, the upstream firm might have low incentive to engage in price-cut competition with other up-stream enterprises in order to serve the downstream undertaking's pre-integration. The rival upstream firm

On the other hand the ‘dominant’ test may also carry a risk of leading to over-enforcement. For example, a merger could only have a trivial impact on competitive performance, but it would still be caught because of the merging parties’ dominant position pre-merger.⁷⁹ Secondly, the position of market share and concentration ratio were changed from exclusive factors to the ‘first indicative’ factors for deciding unilateral effects.⁸⁰ Thirdly, as the assessment of merger case is changing to consider the effects of company’s actions on the market, the Commission needs to identify the efficiencies initiated by a merger, and the extent to which the negative effect on consumers can be outweighed by the efficiency gains.⁸¹ Fourthly, institutional development was conducted for a ‘more economic approach’.⁸² Regarding the transparency of merger assessment of horizontal mergers the Commission published Guidelines on Horizontal Mergers. The Guidelines contribute to clarifying the economic framework for assessing the

can charge higher prices for their products. As the downstream enterprises, they may pass the increase in cost onto the price of final product and consumer welfare is the worse off.

⁷⁷ A single potential entrant exercises a constraint not on any individual incumbent firm, but more generally, on all member of the oligopoly. A pre-emptive take-over of the potential entrant by an incumbent will allow all members of the oligopoly to raise prices even if there are no dominant enterprises and no possibility tacitly to collude. See L Roller and M Mano, the Impact of the New Substantive Test in European Merger Control, *supra* note 14,19; see also, A Lindsay, *the EC Merger Regulation: Substantive issues*, *supra* note 15, 355.

⁷⁸ Although merging parties have relatively low combined market shares measured by sales or total capacity, their competitors are capacity constrained, which may enable the merged group profitably to reduce its output and raise prices following the merger.

⁷⁹ To avoid raising anti-competitive concerns merging parties may divide an anti-competitive transaction into several trivial mergers. In order to prevent such situation the Commission will evaluate the aggregate effect of several mergers which take place within a certain number of years between the same entities. The Commission regulates rules that ‘two or more transactions which take place within a two-year period between the same persons or undertakings shall be treated as one and the same concentration arising on the date of the last transactions’. See article 5(2), Guidelines on Horizontal Mergers, *supra* note 1.

⁸⁰ J B Baker and C Shapiro, Reinventing horizontal merger enforcement, *supra* note 2.

⁸¹ Efficiency created by a merger will be considered if it is merger-specific, timely, verifiable and benefits consumers. See paragraphs 76-88, Guidelines on Horizontal Mergers, *supra* note 1.

⁸² The institutional developments include establishing the European Competitive Network (ECN) and Economic Advisory Group on Competition Policy (EAGCP). They support case team of merger review to share technical expertise and to improve understanding of complicated analysis tools. L Roeller and O Stehmann, The year 2005 at DG competition: The trend towards a more effects-based approach, *supra* note 73, 285.

competitive effects of horizontal mergers, and also illustrate the extent to which economics has been explicitly adopted in EU merger assessment.⁸³

3 Horizontal Mergers: Evaluating Unilateral Effects in China⁸⁴

There is no dedicated guideline on the assessment of horizontal mergers in China. In the examination of all the concentrations the MOFCOM shall consider the relevant elements as follows:

(1) the market share of the business operators involved in the relevant market and their market power; (2) the degree of concentration in the relevant market; (3) the influence of the concentration on the market access and technological progress; (4) the influence of the concentration on the consumers and other business operators; (5) the influence of the concentration on the national economic development; and (6) other elements that may have an effect on the market competition and shall be taken into account as regarded by the Anti-monopoly Authority under the State Council.⁸⁵

As a supplement to the AML 2008 the Interim Rules on Evaluating Competitive Effects of Concentration of Business Operators (hereinafter ‘Interim Rules’) states that the MOFCOM will consider the following items in determining whether a

⁸³ D Ridyard, The Commission’s New Horizontal Merger Guidelines: an Economic Commentary, *The Global Competition Law Centre Working Papers Series (GCLC Working Paper 02/05)*, 12, available at: http://www.coleurope.eu/sites/default/files/research-paper/gclc_wp_02-05.pdf (accessed on the 8th June 2013).

⁸⁴ See N Duan, *Research on EU <Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentration between Undertakings>* [《欧盟《横向并购指南》研究, Oumeng <Hengxiang Binggou Zhinan> Yanjiu] (Master’s thesis), (2009), Available in Chinese National Knowledge Infrastructure (CNKI) Database; H Wu and X Shan, Discussion of Horizontal Mergers Guidelines of China [中国企业横向并购指南探讨, Zhongguoqiye Hengxiang Binggou Zhinan Tantaol], (2007) Volume 5, *Journal of Social Sciences* [《社会科学, Shehui Kexue》], pp.315-323; X Zhang, *Unilateral Effects of Horizontal Mergers: Theory, Evidence and Antitrust Policy* [《横向合并的单边效应: 理论、实证与反垄断政策, Hengxiang Hebing de Danbian Xiaoying: Lilun, Shizheng yu Fanlongduan Zhengce》] (PhD Thesis), (2011), Available in Chinese National Knowledge Infrastructure (CNKI) Database.

⁸⁵ Article 27, the AML 2008,

business operator obtains or increases the degree of control over the relevant market:

i the market share of merging parties and the competition in relevant 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.⁸⁶

The following will review how these factors are applied in practice in analysing the unilateral effect of horizontal mergers. Pursuant to Article 4 of the Interim Rules, when evaluating the likelihood of adverse effects of concentration on the competition in the market, the MOFCOM will firstly examine whether the merged entity would result in or strengthen a business operator's ability, incentive and possibility to exclude or restrict competition unilaterally.

3.1 Initial Review of Market Shares and Concentration Ratio

The Interim Rules require the MOFCOM, in line with other major anti-monopoly jurisdictions, to adopt the Herfindahl-Hirschman Index (“HHI”) and the Concentration Ratio Index (“CR_n”) to measure market concentration level in its

⁸⁶ Article 5, Interim Rules on Evaluating Competitive Effects of Concentration of Business Operators (hereinafter the Interim Rules), (29th August, 2011), MOFCOM Announcement No. 55. The rule has no official English translation. An unofficial English translation is available in the appendix.

review of merger.⁸⁷ The higher the market concentration level, the more anti-competitive effects a concentration would be deemed to have.⁸⁸ In general the MOFCOM considers that very large market shares – 50% or more – may in themselves be evidence of the existence of a dominant market position. The MOFCOM considers that merger would lead to the creation or the strengthening of a dominant position if it results in firms' holding market shares between 40% and 50%.⁸⁹ The market share levels indicating likelihood of a dominant market position accord with those of the EU.⁹⁰

In the first two published cases concerning horizontal issues high market share seems to be considered by the MOFCOM to be a sufficient condition to raising unilateral effect. *InBe/Anheuser-Busch* was the first case in which the MOFCOM imposed restrictive conditions. The MOFCOM indicated that the market power of the merged entity would be increased significantly only because 'the scale of the transaction is large and market share of merged entity will be high'.⁹¹ In *Mitsubishi/Lucite* the MOFCOM stated the concentration was very likely to impose adverse effects on the PRC MMA market since 'market share after this concentration will reach 64% which is much higher than Jilin Petrochemical Co., Ltd. and Heilongjiang Longxin Company, who rank in the second and the third place, respectively. The market dominance will enable Mitsubishi to exclude and restrict competitors after concentration'.⁹² In later cases, apart from high market share, additional factors were involved in considering market structure, such as the disparity of market shares between merged entity and the next competitors,

⁸⁷ The concept of HHI is explained in *supra* note 18. Concentration ratio here means the total market shares of the top N largest firms in the relevant merging market. See Article 6, *ibid*.

⁸⁸ See Articles 27 (1) and (2) of the AML 2008; article 5 of the Interim Rules, *supra* note 86.

⁸⁹ In *Phizer/Myeth* the share of the merged entity in the relevant market would be 49.4%; in *Panasonic/Sanyo* the share of the merged entity in civilian-use NiMH Battery market would be 46.3%; in *Seagate/Samsung* the share of the merged entity in the relevant market would be 43%.

⁹⁰ See paragraph 17, Guidelines on Horizontal Mergers, *supra* note 1.

⁹¹ Point 3, Announcement of MOFCOM [2008] No.95, *Inbev/Anheuser-Busch*.

⁹² Section V, paragraph 1, Announcement MOFCOM [2009] No.28 *Mitsubishi Rayon/Lucite*.

and concentration level in the market. The HHI index was used in assessment for the first time in *Pfizer/Wyeth*.⁹³

According to the approach of the EU there are two misunderstandings if the MOFCOM took high market share of merged entity as the sufficient condition of unilateral effects. First of all high market share does not mean a dominant position. Independent price increase of merged entity may be unprofitable because of constraint from its competitors, buyers or final customers post-merger. In *Urakali/Silvinct* the MOFCOM identified unilateral effects of concentration because the merged company would have more abundant potassium resources and greater capacity in production, supply and export, and thus more control over the global potassium chloride market. This would have an adverse impact on the global maritime trade in potassium chloride, including the Chinese market.⁹⁴ According to the investigation of the MOFCOM:

The world's second largest potassium chloride supplier will be created upon completion of this concentration of business operators. The merged company's market share will exceed 1/3 of the global market, and together with the world's largest potassium chloride supplier, they control about 70% of the global supply of potassium chloride.⁹⁵

However, the increased market power of the merged entity may be constrained by the first largest potassium chloride supplier. The latter may increase output upon facing the price increase of the merged firm, unless the merged entity is able to hinder its expansion. Customers will switch from the merged firm to the largest

⁹³ Apart from the disparity of market shares between merged entity and other competitors, the MOFCOM raised unilateral effects of the merger depending on the results of HHI as well. It said in the case decision, 'according to the investigation of the MOFCOM, the merged firm will own 49.4% market share in the relevant market (of which Pfizer owns 38% and Pfizer owns 11.4%), which is much higher than other competitors. Intervet, who is the second biggest rival of merged entity, only has 18.35% market share, and other competitors' market share is less than 10%. In addition, 'according to data collected by MOFCOM, HHI Index shall be 2181 after concentration, increased by 336 Concentration level was considered to be significant increased by the concentration.' Section 4, (ii)-2, Announcement MOFCOM [2009] No.77 *Pfizer / Wyeth*.

⁹⁴ Paragraph 4, Section two, Announcement MOFCOM [2011] No.33 *Uralkali/Silvinit*. Apart from high market share of the concentration, investigation also found the barriers to entering the relevant market were high. Paragraph 6. Section two, Announcement MOFCOM [2011] No.33 *Uralkali/Silvinit*.

⁹⁵ Paragraph 3, Section two, *ibid*.

supplier, and the loss in sales will render the price increase of the merged entity unprofitable. The MOFCOM does not exclude the possibilities of competitive restraints from competitors of merging parties or customers. On the other hand, the acquired party may be a small firm, although acquiring party is close to being dominant. In this case merger may create dominance, while the merger itself may have only a negligible impact on the change in competitive performance. For instance, in *Novartis/Alcon* the MOFCOM found that the incumbent market share of Alcon in China was over 60%, while Novartis' share of this Chinese market was less than 1%. The MOFCOM still raised anti-competitive concern, although Novartis notified its decision to withdraw its existing operations in the global and Chinese markets for the relevant product.⁹⁶ Such anti-competitive concern might be a false negative error.

On the other hand unilateral effects were not raised in transaction when the market share of the merged firm was below 40% post-merger.⁹⁷ This may be because the MOFCOM still considers high market share a necessary condition to raising competitive concerns. However, anti-competitive concern still exists in the absence of a dominant firm. This has been proved in previous EU cases.⁹⁸ Failing to consider such a scenario may result in a false positive decision. As outright clearance decisions are not disclosed, it is unknown whether such false positive situations have already occurred.

⁹⁶ The MOFCOM had concerns about the prospect of Novartis' seeking to strengthen its position in the relevant market in China by reserving its withdrawal decision after its acquisition of Alcon. However, the MOFCOM did not give any evidence on the ability or incentive of Novartis to access a relevant market in future as a potential entry. Paragraph 1, Section four, Announcement MOFCOM [2010] No.53 *Novartis/Alcon*.

⁹⁷ In the exceptional case of *Glencore/Xstrata* the combined market share of the merged entity was only 17.8% in China's import market of copper concentrate. The MOFCOM still raised anti-competitive concerns because the transaction risked significantly increasing the vertical integration in the industry chains of copper. The market power of the merged entity would not be ameliorated by the restraint of prevailing competitors nor by the ability of competitors to enter the market, nor by countervailing buyer power. Case study is available at N Dodoo *et al.* (Clifford Chance), Implications of China's conditional competition approval of Glencore/Xstrata, 24 April 2013, *Publications & Views*, available at: http://www.cliffordchance.com/publicationviews/publications/2013/04/implications_of_chinascondition_alcompetitio.html (accessed on the 7th June 2013); The Commission approved the transaction subject to conditions as well. See Case COMP/M.6541 *Glencore/Xstrata*, [2012] O.J. C304/6.

⁹⁸ See '2.1 Initial Review of Market Share and Concentration Data' in this chapter.

In *Marubeni/Gavilon* the MOFCOM defined the relevant market as China's import market for soybean, corn, bean pulp and dry and course distillers' grains.⁹⁹ In 2012 China imported 58.38 million tons of soybeans. Marubeni, as one of the main soybean exporters, exported 10.5 million tons of soybean to China. The acquired firm (Gavilon) only exported 400,000 tons of soybean. According to the evidence, the market share of the merged entity in China's import market for soybean would not be improved significantly (about 0.7%). However, the MOFCOM was concerned that the deal would significantly boost Marubeni's access to global soybean resources through the acquisition of Gavilon's capacity for soybean origination, storage and logistics in North America, thus enhancing Marubeni's ability to export soybean to China. However, the MOFCOM did not clarify how such combination could impede effective competition in China's import market of soybean.¹⁰⁰ It is presumed such improvement in market power can be conducted through two channels. On the one hand the acquired entity Gavilon would significantly expand its export of soybean to the Chinese market by using the acquired entity Merubeni's distribution channel in China's relevant market. However, the MOFCOM did not show whether the import of soybean from Gavilon would substitute the import from Merubeni. If they were not the closest substitutes, customers would switch to buying products from rivals of merging parties which would make the price increase of the merged entity unprofitable. Unilateral effects of merger could be excluded. Nor does the MOFCOM investigation prove that Gavilon, as a potential competitor, would have excessive ability and incentive to increase procurement of soybean in order significantly to increase its supply of soybean to China. Thirdly, the MOFCOM appears not sufficiently to have considered the degree of competitive constraint provided by rivals of merging parties or the ability of competitors to expand in response to attempts by the merged firm to increase

⁹⁹ Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon*.

¹⁰⁰ see N Dodoo *et al.* (Clifford Change), MOFCOM's conditional approval of Marubeni/Gavilon and implications for mergers in the agricultural sector, (7 May 2013), *Publication & Views*, available at: http://www.cliffordchance.com/publicationviews/publications/2013/05/mofcom_s_conditionalapproval_fmarubenigavilo.html (accessed on the 8th June 2013); H Ha *et al.* (Mayor Brown), MOFCOM conditionally approves Marubeni/Gavilon: competition law and industrial policy in the agricultural sector, (8 May 2013), *publications*, available at: <http://www.mayerbrown.com/mofcom-conditionally-approves-marubenigavilon-competition-law-and-industrial-policy-in-the-agricultural-sector-05-08-2013/> (accessed on the 8th June 2013).

prices and/or lower output.¹⁰¹ Finally, the MOFCOM required the merged entity within six months to establish two separate legal entities and two independent operating teams to export and sell soybean to China, and report the plan of implementation to a supervising trustee approved by the MOFCOM.¹⁰² The MOFCOM's reasoning in this case led to much criticism, especially since the transactions were cleared outright both in the EU and US jurisdictions.¹⁰³

In conclusion, China appeared to adopt policies that closely resembled the old EU 'dominant' test idea which has been abandoned. On some occasions the MOFCOM may still take dominant position as a necessary and sufficient condition to show anti-competitive effect. This may lead to a false negative condition in concentration with high market share after merger, and lead to a false positive condition in concentration with relatively low market share. This might also be the reason why there is no 'maverick' merging party to raise horizontal competitive concern with market share below 40%.¹⁰⁴ Recently the MOFCOM has been trying to accept that dominant position is neither a necessary nor a sufficient condition of anti-competitive concern. However, the reasoning for concerns of unilateral effects is still ambiguous when market share of merging parties is not high.

HHI levels, in combination with the relevant deltas, may be used as an initial indicator raising competition concerns. The MOFCOM identifies horizontal competition concerns in mergers with post-merger HHIs above 2,000 and deltas above 250.¹⁰⁵ However, unlike the EU, the MOFCOM does not clarify a 'safe

¹⁰¹ See H Ha *et al.* (Mayor Brown), *ibid.*

¹⁰² Section 4-a-1), Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon*.

¹⁰³ Criticisms refer to note 100 *supra*. The EU Case is COMP/M.6657 *Marubeni Corporation/Gavilon Holdings*, [2012] O.J.C261/1.

¹⁰⁴ One reason may be that the merger control under MOFCOM is too young which has not met related transactions. As cases of clearance are not published, we are unable to detect if any false positive scenario has occurred.

¹⁰⁵ In *Phizer/Wyeth*, according to data collected by the MOFCOM, the HHI Index was 2181 after concentration, increased by 336. This was used to indicate a significant increase of concentration degree; in *UTC/Goodrich*, HHI (7158) and delta value (1728) were used to indicate a very high level of market concentration.

harbour' criterion with HHI index as an initial indicator excluding competition concerns.¹⁰⁶

3.2 Merging firms are close competitors

Similarly to the EU, in assessing the market power of the merged group the MOFCOM considers the degree of substitutability between merging parties themselves and with their competitors in a relevant market.¹⁰⁷ The extent of substitution for products within the same market was not investigated in every case. *Seagate/Samsung* was a typical instance of negligence.¹⁰⁸ This transaction in China was considered to raise the unilateral effects which would eliminate and restrict competition.¹⁰⁹ Nevertheless, the Commission granted unconditional clearance to *Seagate/Samsung*.¹¹⁰ One important reason for the different outcome was that the Commission did not consider Samsung to be the closest competitor of Seagate within the relevant hard disk drive (HDD) market. The Commission determined that Seagate, West Digital (WD) and HGST belonged to Tier-one standard quality, whereas Samsung did not. The investigation confirmed that Samsung was regarded as a second-tier player with weaknesses in terms of cost competitiveness, difficulties in expanding production capacity and weakness in the development of original technologies. Samsung had struggled with sustained deficits.¹¹¹ WD and HGST appeared to be closer competitors with Seagate than Samsung.¹¹² Although the market share of the merged entity and the increment that the proposed transaction would bring about were significant, the merged

¹⁰⁶ For more about HHI levels in the EU, refer to paragraphs 19-21, Guidelines on Horizontal Mergers, *supra* note 1.

¹⁰⁷ Article 5-2) and 3), the Interim Rules, see *supra* note 86.

¹⁰⁸ Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹⁰⁹ Paragraph 540, COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3. In addition to non-coordinated effects, the Commission assessed the likelihood of coordination effect and vertical foreclosure because of the merging parties' relationship with the upstream market in media. The final conclusion rests on the finding that the proposed transaction would not significantly impede effective competition in any of the HDD markets.

¹¹⁰ See case *Seagate/Samsung*, *ibid*.

¹¹¹ The analysis showed that overall WD, Seagate and HGST took part in most of the bids for the selected customers, whereas Samsung showed the lowest participation rate. See paragraph 409, case *Seagate/Samsung*, *ibid*

¹¹² Paragraph 415, *ibid*.

entity would continue to face competition from two strong HDD suppliers, WD and HGST.¹¹³ On this conclusion the Commission did not identify Samsung as an important competitive force.

Another relevant case was *InBev/Anheuser-Busch*. The four largest beer companies in China were China Resources Snow Breweries, Tsingtao Breweries, Beijing Yanjing Brewery and Zhujiang Brewery. One report estimated that these four companies accounted for around 41 percent of industry revenue.¹¹⁴ In the beer market it be assumed that the merging parties did not hold dominant positions. Once the undertaking post-merger increased price independently customers could switch to other at least four alternative suppliers. The loss of sales can trade off the profits of price increase. Therefore the merged firm would have no incentive to increase prices and harm consumer welfare. The MOFCOM did not indicate its consideration of the likelihood of such switch.

The next question is why is the MOFCOM's conclusion about the extent of substitution among products different from that of the EU? Was it because of the different market situations in the EU and China? Such doubt can be eliminated in *Seagate/Samsung*. Both the EU and China revealed that the relevant product market was the hard disk drives (HDDs) market,¹¹⁵ and the relevant geographic market was worldwide.¹¹⁶ The two regimes had agreed on the scope of the relevant market. Was it because the MOFCOM did not investigate the substitution as thoroughly as did the EU? Actually, the MOFCOM divided the HDDs market into four sub-markets according to different end-use, namely enterprise applications, desktop applications, portable computer applications and consumer electronics

¹¹³ Paragraph 406, *ibid*.

¹¹⁴ See the Report on Development Strategy of Beer Industry in China 2008, March, 2008, available at: http://www.reportbus.com/Article/SP/PJ/200801/Article_78181.html (accessed on the 13th May 2013).

¹¹⁵ The Commission even divided the HDDs market into seven segments according to their difference end-use. However, even in the narrower market, the Commission still believed Samsung was not particularly close to the Seagate product. See paragraph 82-262, COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3.

¹¹⁶ The MOFCOM defines the relevant market as the worldwide HDD market. This HDD market is found to be highly concentrated within five manufacturers, including Seagate (33%), Western Digital (29%), Hitachi (18%), Toshiba (10%) and Samsung (10%), whether worldwide or in China. See Point 2-(1), Announcement MOFCOM [2011] No.90 *Seagate/Samsung*. See also section 5.2.3, COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3.

applications. Nevertheless, the MOFCOM did not state whether these four sub-markets substitute each other. In analysing anti-competitive effects of the merger the MOFCOM defined these four sub-markets as belonging to a whole HDDs product market directly without stating its reasons or citing evidence.¹¹⁷

3.3 Customers Have Limited Possibilities of Switching Suppliers, or Competitors are Unlikely to Increase Supply if Prices are Increased

In assessing whether a transaction will create or strengthen market power the MOFCOM considers the ability of consumers to switch their suppliers when the prices of merging parties' products increase.¹¹⁸ No further provisions explain how to conduct the customer investigation. It was only known that the MOFCOM collected the public's online feedback on a transaction once.¹¹⁹ There were four general questions in the questionnaire.¹²⁰ Compared with the EU customer investigation is neither scientific nor systematic.¹²¹

According to article 5 of the Interim Rules, the MOFCOM will assess the production capacity of the business operators in the relevant market which are not involved in the concentration.¹²² In practice the MOFCOM began to consider the rival's

¹¹⁷ Conversely, in the EU four separate relevant product markets are determined: (i) Mission Critical Enterprise HDDs, (ii) 3.5" Business Critical HDDs, (iii) 3.5" Desktop HDDs, (iv) 3.5" CE HDDs, (v) 2.5" Mobile HDDs and (vi) 2.5" CE HDDs. For the content of the substitution test refer to Section 5.2.1, COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3. Recommendations to the MOFCOM on improvements in defining 'relevant market' can be seen in 'section 4 Recommendations for Defining the Relevant Market in China' in Chapter 2.

¹¹⁸ Article 5, the Interim Rules, see *supra* note 86.

¹¹⁹ In assessing *Coca cola/Huiyuan* there was a questionnaire for customers on a popular website in China which is available at: <http://survey.news.sina.com.cn/voterresult.php?pid=26772> (accessed on the 20th September 2012).

¹²⁰ These four questions are 'whether you approve the acquisition of Huiyuan by Coca cola'; 'whether the transaction will raise the concern of eliminating 'national pillar industry'; 'whether respondents are optimistic about Huiyuan juice after the acquisition'; and 'whether they think the 17.9billion HK dollars is appropriate for the transaction.

¹²¹ The approaches to market investigation can be seen in 2.2 Merging Firms Are Close Competitors.

¹²²The Interim Rules, see *supra* note 86.

competitive constraints in light of three factors: market share,¹²³ concentration data and the results of any bidding studies.¹²⁴ In addition the index of capacity use was also adopted to show whether other rivals were able to expand output. In *Seagate/Samsung* the MOFCOM believed the competitors of the merging parties were unlikely to increase their output substantially if prices increased. Such conclusion is deduced from its finding that the unused production capacity of the five HDD manufacturers was very limited due to the recent increase in market demand, noting that capacity use rates were about 90% in the fourth quarter of 2010.¹²⁵

The difference between the EU and China is that the MOFCOM does not state when the rivals of merging parties have incentives to expand output when the merged entity increases price post-merger. In *Panasonic/Sanyo* the MOFCOM identified that Panasonic would have power to raise price unilaterally post-merger. One reason was that Panasonic's price increase might be beneficial to other competitors who will not have incentives to effectively restrain the price increase of Panasonic. However, the MOFCOM did not explain why it is optimal for the competitors to raise prices in response to higher prices set by the merged entity rather than expand output in order to get a greater market share.¹²⁶

¹²³ In *Panasonic/Sanyo* the MOFCOM found that the structure of Button-type Rechargeable Lithium Battery market was highly concentrated. The merging parties were the largest and second largest manufacturers respectively in the market. After the concentration, Panasonic would have a 61.6% market share. Since most of the downstream customers adopt the policy of procuring products from two or more suppliers, the restrictive competitive effect resulting from the concentration would be more significant. See Case Announcement MOFCOM [2009] No.82 *Panasonic/Sanyo*.

¹²⁴ In *Seagate/Samsung* the relevant product market was in HDDs. The buyers (computer manufacturers) use confidential bidding to purchase HDDs. In order to ensure continuity and security of production computer manufacturers distribute their order to two to four suppliers. During bidding, the most competitive suppliers get the largest order, secondary suppliers get a smaller order and worse suppliers have no order. Merger reduces the number of HDDs' producers from five to four, and increases the chance of remaining producers to get orders at the same time. There would be less pressure of competition to win orders in bidding process post-merger. See section 2, point 8, Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹²⁵ Ibid.

¹²⁶ See Point 4-(2), Announcement MOFCOM [2009] No.82 *Panasonic/Sanyo*.

3.4 Merged Entity Able to Hinder Expansion by Competitors

According to Article 5 of the Interim Rules the MOFCOM will assess the ability of the business operators involved in the concentration to control sales or supplies, and the financial and technical capacity of those involved in the concentration.¹²⁷ The advantages of merged entity in supplies, distribution or finance may not be sufficient to affect the expansion of its competitors.

In *Seagate/Samsung* the European Commission found before the proposed transaction that Seagate was vertically integrated into the upstream supply of components for HDDs, notably heads and media. After the proposed transaction the combined entity might prefer in-house supply of heads and media to purchases on the merchant market.¹²⁸ The Commission therefore carried out an assessment on the risk of customer foreclosure stemming from the proposed transaction to the detriment respectively of heads and media suppliers.

In assessing the likelihood of anti-competitive customer foreclosure the Commission examined whether

- (i) the combined entity would have the ability post-merger to foreclose access of heads' and/or media's suppliers to a sufficient customer base by removing Samsung as an independent market player and significant customer;
- (ii) the combined entity would have the incentive to do so;
- (iii) a foreclosure strategy would have a negative impact on the viability of heads' and/or media's suppliers' business;
- (iv) a foreclosure strategy would have a significant detrimental effect on the downstream markets for HDDs by impairing competitor (Toshiba)'s ability to effectively compete in those

¹²⁷ Points 4 and 6, Article 6, the Interim Rules, see *supra* note 86.

¹²⁸ paragraph 557, COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3.

markets and therefore by allowing the merged entity to raise HDDs' prices.¹²⁹

The investigation showed that:

(i) the merged entity would not be able to foreclose external sourcing (TDK) from Samsung's purchases in the short term as it does not currently have spare capacity to meet the overall heads demand of Samsung; (ii) the merged entity would have limited incentives to source all its heads requirements internally; As a consequence, the ability of downstream HDDs producer (Toshiba) to source sufficient and competitive heads will not be negatively impacted by the proposed transaction. Therefore, potential customer foreclosure after the proposed transaction is unlikely to undermine Toshiba's competitiveness in the HDD markets.¹³⁰

Therefore, although the merging party has a vertical relationship with the upstream market for heads, merger would have no significant effect on components' suppliers or in consequence on the downstream HDDs markets.¹³¹

Of the same transaction the MOFCOM did not mention the merging parties' vertical relationship with the upstream market. Actually, in *Mavebeni/Gavilon* the MOFCOM had the opportunity to explain how the merged entity was able to hinder the expansion of competitors. Nevertheless, the MOFCOM only stated, 'in China, the merging party (Mavebeni) has more advantages than its competitors in distribution and client resources than its competitors'.¹³² There was no further investigation to show whether the advantages of the merging parties are sufficient to deter the expansion of competitors.

¹²⁹ See paragraph 560, *ibid.*

¹³⁰ This was the result of investigation of the likelihood of transaction to the detriment of heads suppliers. Paragraph 568, *ibid.*

¹³¹ *Ibid.*

¹³² Point 1 in Section 3, case *Mavebeni/Gavilon*.

In addition, the economies of scale owned by the merged firm were considered by the MOFCOM in a number of reported cases. Nevertheless, it is noted that economies of scale that would result from the merger are used as evidence of increased market power, rather than representing potential benefits to society.¹³³ Merger-related efficiencies were often used as evidence against a proposed merger.¹³⁴

3.5 Merger eliminates an important competitive force (sometimes referred to as a ‘maverick’)

Pursuant to the experience of the EU it is recognised that although merging firms have no significant market share, they can significantly constrain competition if they are recent entrants or innovative (‘maverick’ firms).¹³⁵ However, as the MOFCOM mostly relies on the market share to assess the competitive effect, it may clear merger with a ‘maverick’ firm, which leads to a false positive outcome.

Overall, China’s merger control provisions as contained in the AML 2008 are in line with international standards. The various factors that are listed to assess unilateral effects are broadly similar to the key aspects of merger assessment that have been adopted by the EU. The following discusses disparities between the EU and China in assessing unilateral effects.

First of all the MOFCOM is more conservative than European authorities. This has resulted in the same transactions’ being cleared outright in the EU but cleared with commitments by the MOFCOM. Examples are the recent cases involving the

¹³³ In *Pfizer/Wyeth* because of the high barriers to entry the MOFCOM stated that post-merger Pfizer was very likely to use the scale advantage further to expand its market in China, to compress the market space of other enterprises. See point 2, part four, Announcement MOFCOM [2009] No.77 *Pfizer/Wyeth*. Similar concern also appears in *Savio/Penelope*, *Seagate/Samsung*, and *Western Digital Ireland/Viviti Technologies*. See paragraph 7, part two, case Announcement MOFCOM [2011] No.73 *Savio/Penelope*; paragraph 7, part two, Announcement MOFCOM [2012] No.09 *Western Digital Ireland/Viviti Technologies*.

¹³⁴ This line of reasoning coincides with the early approach of US antitrust authorities during the 1960s-1970s; see P Lin and J Zhao, Merger Control Policy under China’s Anti-Monopoly Law, (2012) Volume 41, Numbers 1-2, *Review of Industrial Organization*,126.

¹³⁵ Paragraphs 37 and 38, Guidelines on Horizontal Mergers, *supra* note 1.

global hard disk drive market of *Seagate/Samsung* and *Western Digital/Hitachi*.¹³⁶ These two transactions were both notified elsewhere, including in the EU and the US. Both the EU and US cleared the transaction *Seagate/Samsung* without condition, and cleared the transaction *Western Digital/Hitachi* with a divestment remedy. The MOFCOM went further than the EU and the US agencies on both occasions. It imposed behavioural remedies on *Seagate/Samsung* and both behavioural and structural remedies on *Western Digital/Hitachi* even though the relevant markets examined were the same in the EU and China.¹³⁷ Secondly, although the MOFCOM had already shown a fast learning ability in the 19 reported merger cases, the reasoning justifying a case decision in case decisions still needs to be made clear. There is much room for improving clarification.¹³⁸ Thirdly, there is no analytical framework within which unilateral effects are analysed. Considerations in each decision are various and uncertain. In the first two cases the MOFCOM only considered competitive effects from the indication of market shares. More factors were considered in the following cases. Fourthly the EU conducts deeper and more systematic investigations into the extent of substitution among competitors within the same relevant market.¹³⁹ Finally, there is the no consideration of ‘maverick’ firms. This might be the result that the MOFCOM still relies on the ‘dominant’ test in merger assessment.

¹³⁶ In China these two cases are Announcement MOFCOM [2011] No.90 *Seagate/Samsung*; Announcement MOFCOM [2012] No.09 *Western Digital Ireland/Viviti Technologies*; in the EU, these two cases are COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3; Case COMP/M.6203 *Western Digital Ireland/Viviti Technologies* [2011] O.J. C 165/4.

¹³⁷ Of the published 19 cases four transactions were cleared outright in the EU, while they were approved subject to conditions in China. Two of the four cases raised horizontal concerns, namely *Seagate/Samsung* and *Marubeni/Gavilon*. Another two cases concerned vertical merger, *General Motors/Delphi* and conglomerate merger, case *Google/Motorola Mobility*. See Announcement MOFCOM [2009] No.76 *General Motors / Delphi*; Announcement MOFCOM [2012] No.25 *Google / Motorola Mobility*; Announcement MOFCOM [2011] No.90 *Seagate / Samsung*; Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon*.

¹³⁸ P Lin and J Zhao, *Merger Control Policy under China’s Anti-Monopoly Law*, (2012) Volume 41, Numbers 1-2, *Review of Industrial Organization*, 130; Freshfields Bruckhaus Deringer LLP, Key trends in PRC merger control over the last year, August 2012, available to see at: <http://www.freshfields.com/uploadedFiles/SiteWide/Knowledge/Key%20trends%20in%20PRC%20merger%20control%20.pdf> (viewed on the 22nd September 2013). The MOFCOM is only required to publish decisions to block transactions or impose restrictive conditions on a transaction. See Article 30, the AML 2008.

¹³⁹ See ‘3.2 Merging firms are close competitors’ in this chapter.

4 Discussion and Recommendations

4.1 Reasons for Differences

4.1.1 Still in the Process of Learning

It has only been five years since entry into force of the AML 2008.¹⁴⁰ This young regime is still in the process of learning from various developed and mature regimes in the world. The Merger Regulation in the EU has been implemented for 22 years since it came into force on 21st September 1990.¹⁴¹ Looking back to the history of merger review in the EU, the first five years can only be seen as a discovery phase.¹⁴² The Commission issued a number of Notices intended to provide guidance on the jurisdictional and substantive scope of the Merger Regulation, and prohibited a transaction for the first time in 1991.¹⁴³ More substantial improvements were adopted in the following years.

¹⁴⁰ The AML 2008 came into force on 1st August 2008.

¹⁴¹ Council Regulation (EEC) No. 4046/89 of 21 December 1989 on the control of concentrations between undertakings, O.J. L 395, 30.12.89. This Regulation introduced into EU competition law a legal framework for the systematic review of mergers, acquisitions and other forms of concentration, with amendments introduced by Council Regulation 1310/97, 1997 O.J. L180/1; corrigendum 1998 O.J. L40/17. Further changes to the Merger Regulation were agreed in November 2003 (Commission Press Release IP/03/1621 of November 27, 2003) and formally adopted in January 2004 (Commission Press Release IP/04/70 of January 20, 2004). Before that, merger control was under the regulation of Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), O.J.C115/47.

¹⁴² During this period the Commissions' application of the Merger Regulation exceeded the expectations of the most optimistic commentators in several important respects: 1) the Commission met the right deadlines prescribed in the Implementing Regulation in virtually every case; 2) the Commission was flexible and open in its application of the procedural rules of the Merger Regulation, notwithstanding the significant innovations in practice; 3) the Commission began to use economic evidence and systematic marketing testing; 4) the Commission proved itself able to withstand political pressure; 5) the Commission worked closely with Member State authorities, using the Member Regulation to develop a common appreciation of competition law and policy across the EU; and 6) the Commission started the process of fostering international cooperation with other antitrust authorities, including, in particular, the US federal agencies. See N Levy *et al.*, *EU Merger Control: A Brief History*, (2004), p10, available at: http://www.cgsh.com/files/Publication/39346756-bc80-4fd2-9584-f358ffc72239/Presentation/PublicationAttachment/05b61f33-f646-4c9e-a7ec-f6b8b0bfce4f/CGSH_CGSH_Paper_IBC_Conference_EU_Merger_Control_-_A_Brief_History.pdf (accessed on the 24th September 2012); a prior version of this paper entitled *EU Merger Control: From Birth to Adolescence* was published in *World Competition*, (2003) Volume 26, Number 2, pp.195-218.

¹⁴³ These provisions are: i) the notion of a concentration, [1994] O.J. C385/5; ii) the calculation of turnover, [1994] O.J. C385/21; iii) the distinction between co-operative and concentrative joint

Between 1995 and 1998 there was increasing maturity, confidence and sophistication in the Commission's substantive review of reportable transactions. The Commission's decisions reported after Phase II investigation became increasingly detailed and lengthy;¹⁴⁴ transactions might be prohibited largely because of vertical effects.¹⁴⁵ The Commission also began to consider conglomerate or 'portfolio' effects in cases, and the Court confirmed that 'a failing firm defence is available under the Merger Regulation.'¹⁴⁶

During the period 1999 to 2001 the Commission employed an increasingly wide array of antitrust theories, including: 1) neighbouring market and potential entrant theories; 2) conglomerate and portfolio effects; 3) vertical effects; and 4) spill-over effects;¹⁴⁷ The Commission for the first time identified single-form dominance concerns where the transaction market share would have been below 40%.¹⁴⁸ The Commission applied the Merger Regulation's procedural rules more rigorously, including, in particular, those barring consideration of remedies offered out-of time.¹⁴⁹

In 2002 a number of reforms were adopted. The package reform included a wide-ranging revision of the Merger Regulation (the 'Draft Merger Regulation'),¹⁵⁰ a Draft Horizontal Mergers Notice¹⁵¹ and Draft Best Practices Guidelines.¹⁵² The Commission intended to clarify the law in three significant ways: the first was intended to

ventures, [1994] O.J. C385/1; and iv) the notion of 'undertakings concerned', [1994] O.J. C385/12. The first prohibition case was *Aerospatiale-Alenia/de Havilland* in 1991. It was not until 1994 that the Commission prohibited a second transaction; see Case IV/M.469 *MSG Media Service* [1994] O.J. L364/1. Case IV/M.53 *Aerospatiale-Alenia/de Havilland*, [1991] O.J. L334/42.

¹⁴⁴ Example of cases can refer to note 37 in N Levy *et al.*, EC Merger Control: A brief History, *supra* note 142.

¹⁴⁵ Example of cases can be seen in note 39 in N Levy *et al.*, *ibid.*

¹⁴⁶ Note 44 in *ibid.*

¹⁴⁷ Note 50-53 in *ibid.*

¹⁴⁸ In Case *Carrefour/Promodes*, merging parties would supply 20-30% consumer products to French supermarkets. The Commission still raised the concern that the merged entity could exert market power over suppliers. See Case COMP/M.1684 *Carrefour/Promodes*, [2000] O.J. L164/5.

¹⁴⁹ Note 56 in N Levy *et al.*, EU Merger Control: A Brief History, *supra* note 142.

¹⁵⁰ Note 89, *ibid.*

¹⁵¹ Note 90, *ibid.*

¹⁵² Note 91, *ibid.*

remedy the ‘enforcement gap’ of the ‘dominance’ test with SIEC test; in the second the Commission considered accepting the analytical framework of collective dominance based on *Airtours* case;¹⁵³ thirdly the Commission began to recognise that assessments made under the Merger Regulation should ‘take account of any substantiated and likely efficiencies put forward by the undertakings concerned’ as ‘it is possible that the efficiencies brought about by the concentration [may] counteract the effects on competition.’¹⁵⁴ Therefore, after 14 years of development, the Commission finally adopted its current Horizontal Mergers Notice in 2003 which ‘provides a sound economic framework for the assessment of concentration’.¹⁵⁵ In addition, for more extensive and detailed analysis, the Commission appointed its first chief economic expert in the Merger Team Force.¹⁵⁶

The EU issued its Horizontal Merger Notice based on 14 years of development. Compared with the history of the EU the MOFCOM may lack sufficient case experience to establish a proper economic framework for the assessment of horizontal concentration in five years of implementation. However, the trend of improvement in the EU could be an example for the MOFCOM to follow.

4.1.2 Restricted Communication amongst the MOFCOM, Notifying Parties and the Third Parties

Lack of communication may explain the different case decisions on the same transaction in the EU and China. The enforcement authorities’ power to collect information is similar in the EU and China.¹⁵⁷ However, the Commission has deeper

¹⁵³ This decision will be further analysed in Chapter 4.

¹⁵⁴ Recital 29, Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), [2004] O.J. L24 (hereinafter EUMR).

¹⁵⁵ Recital 28, EUMR.

¹⁵⁶ Note 105 and 106 in N Levy *et al.*, EU Merger Control: A Brief History, *supra* note 142.

¹⁵⁷ Merger assessment on *Seagate/Samsung* got different decisions in the EU and China. Reasons leading to the difference can see following ‘4.2.7 Improving Communication amongst the MOFCOM, Notifying Parties and Third Parties’ in this chapter. The Commission has power to collect information from merging parties, or third parties (e.g. customers, upstream suppliers, or rivals), by means of a simple requires or decision or an inspection. See Article 11 and 13 EUMR. Similar power of the MOFCOM in investigation can see in Article 6 of the Ministry of Commerce of the People’s Republic of

investigation with its power. This is because notifying parties and related third parties have more opportunities to know the concerns of the Commission, and have more channels to make their views known by the authority before a final decision is made.

4.2 Recommendations

4.2.1 Rewording the Substantive Test

The AML 2008 adopted a substantive test: that a concentration would be prohibited if it ‘has or is likely to have effects of eliminating or restricting competition’ (the ‘EERC’ test).¹⁵⁸ Similar to the ‘SIEC’ test in the EU, the ‘EERC’ test links the result of merger assessment with its effect on prevailing competition rather than the change of market structure. This helps ward off the ‘gap’ of enforcement under the ‘dominant’ test. A merger may raise serious anti-competitive concerns even it does not create or strengthen a dominant position.¹⁵⁹ For example, a merger eliminates potential competition¹⁶⁰ or controls of entry barriers;¹⁶¹ merger between the second and third largest producer in the market which does not create or strengthen the paramount firm in the market; merger creates the likelihood of coordination between the oligopolists or makes

China, Announcement No.12 of 1st January 2010, Measures on the review of concentrations of undertakings (the ‘Review Measures’) and Article 39 of the AML 2008.

¹⁵⁸ Article 28, the AML 2008. However, there is no illustration of the ‘extent’ of effect on competition. Some scholars comment that China adopts the US ‘substantial lessening of competition’ standard. Others believe that the EERC test follows worldwide trends, through combining the ‘substantial lessening of competition’ test and the traditional ‘creation or strengthening of a dominant position’ test. See Z Wu, Study on Anti-Monopoly Law of P.R. China, (2007), *China People's Court Press*, 488; J Shi, Understanding and Using of the Anti-Monopoly Law of P.R. China, (2007), *Beijing: China Legal Publication House*, 237.

¹⁵⁹ The change of substantive test was discussed in K Fountoukakos and S Ryan, A new substantive test for EU merger control, [2005] Volume 26 Issue 5, *E.C.L.R.*, 277; A Heimler, Was the change of the Test for Merger Control in Europe Justified? An Assessment (Four Years after the Introduction of SIEC), (2008) Volume 4 Number 1, *European Competition Journal*, pp. 85-94; L Roller and M Mano, the Impact of the New Substantive Test in European Merger Control, *supra* note 14, pp. 9-28.

¹⁶⁰ See *supra* note 77.

¹⁶¹ Although merging parties have relatively low combined market shares measured by sales or total capacity, their competitors are capacity constrained, which may enable the merged group profitably to reduce its output and raise prices following the merger.

coordination easier; and merger raises rivals' costs.¹⁶² However, unlike the SIEC test under the EUMR, merger review under the 'EERC' test may be overestimated when a merger only carries trivial or non-material reduction of market competition. Actually, any horizontal concentration has the effect of eliminating or restricting competition, as the number of competitors in the market will be reduced. Nevertheless, in practice, all horizontal merger cases have been cleared with or without restrictive conditions.¹⁶³ There is thus a logical paradox between the expression of substantive test in legislation and practice. Hence the substantive test should be amended.¹⁶⁴

The 'SIEC' test has an advantage in clarifying the criteria for merger assessment. The words 'significant impediment' imply that a merger will be prohibited only if it materially reduces or lessens the extent of 'competition' within the market.¹⁶⁵ A merger which does not materially harm consumers could not be prohibited, even if it reduces rivalry by removing an independent supplier from the market.

¹⁶² Vertical integration can greatly harm consumer welfare even if none of the merging firms is *per se* dominant in their respective markets. For instance, if an upstream undertaking merges with a downstream undertaking, the upstream firm might have low incentive to engage in price-cut competition with other up-stream enterprises in order to serve the downstream undertakings pre-integration. The rival upstream firm can charge higher price for its products. As the downstream enterprises, they may pass the increase of cost onto the price of final product and consumer welfare is diminished.

¹⁶³ Only one proposed conglomerate merger case was prohibited by the MOFCOM. See Announcement MOFCOM [2009] No.22, *Coca Cola / Huiyuan*.

¹⁶⁴ For discussion of substantive test see J Shi and S Qian, Study on Chinese Substantive Examination Standard on Concentration of Undertakings from an International Perspective [以国际视野看我国经营者集中的实质审查标准, Yi Guoji Shiye Kan Woguo Jingyingzhe Jizhong de Shizhi Shencha Biaozhun], *China Management Studies*[中大管理研究, *Zhongda Guanli Yanjiu*], (2009) Volume 4, Issue 4, pp.155-169; U Bernitz and S An, An Convergence or parallel paths? Comparison of substantive tests of merger control in EU and China, (2010) Volume 31 Issue 6, *E. C. L. R.*, pp.248-257; Huang Jin, Merger Regulation in China, What Constitutes an Appropriate Regime, available at Asian Competition Forum website: <http://www.asiancompetitionforum.org/asianfile.html> (Accessed on the 19th May 2012); L Ren, *the Criteria of Substantive Test for Vertical Merger Antitrust Review*, [纵向合并反垄断实质审查标准研究, *Zongxiang Hebing Fanlongduan Shizhi Shencha Biaozhun Yanjiu*] (Master's Thesis), (2011), Available in Chinese National Knowledge Infrastructure (CNKI) Database; Y Shen, *Defence Measures for Chinese Enterprises When Facing EU's Merge and Acquisition Review*, [中国企业在欧盟实施并购面临的反垄断审查及应对措施, *Zhongguo Qiye zai Oumeng Shishi Binggou Mianlian de Fanlongduan Shencha Ji Yingdui Cuoshi*] (Master's Thesis), (2011), Available in Chinese National Knowledge Infrastructure (CNKI) Database; Y Liu, *Substantive test and its Defence System in Antitrust Merger Review*, [企业并购中的反垄断实体审查及其抗辩, *Qiye Binggou zhong de Fanlongduan Shiti Shencha jiqi Kangbian*] (Master's Thesis) (2008), Available in Chinese National Knowledge Infrastructure (CNKI) Database.

¹⁶⁵ See N Horner, Unilateral Effects and the EC Merger Regulation – How the Commission had its Cake and Ate it Too?, (2006) Volume 2 No.1, *Hanse Law Review*, pp.23-44.

4.2.2 Market Share and Concentration Ratio

Apart from rewording the ‘substantive test’ criteria,¹⁶⁶ the MOFCOM should also change the competitive assessment from the focus on market structure to a focus on the effect of concentration on competition.¹⁶⁷ Firstly the MOFCOM should use market share and HHI levels as initial indicators of competition concerns, which are not in themselves determinative of whether unilateral effects will arise as a result of a transaction.¹⁶⁸ Concerning concentration with high market share or high HHI level post-merger the MOFCOM should also competitive constraints to price increase of the merged entity from actual or potential competitors, buyers as well as customers. A concentrated market structure might not lead to anti-competitive effect. *Seagate/Samsung* is an example.¹⁶⁹ If merged entity would only have market share below 50% post-merger, the MOFCOM still needs to be careful whether merger eliminates a ‘maverick’ firm in the market. A transaction with no significant market share may also raise competitive concerns.

Secondly the MOFCOM is advised to establish a ‘safe harbour’ for merger assessment. This can increase the predictability of merger assessment.

Transactions with low market shares and concentration ratio can be reviewed in less time and with fewer resources. The MOFCOM can focus more on mergers with significant competitive concerns. The exact standard of safe harbour is still to be issued by the MOFCOM. Adopting the HHI index as the proxy for a safe harbour has its advantages. The HHI index not only shows the extent of concentration in industry, but also reveals the scale of enterprises.¹⁷⁰ The consideration of delta HHI before and after a merger can avoid raising anti-competitive arguments when the

¹⁶⁶ R Gibert and D Rubinfeld, Revising the Horizontal Merger Guidelines: Lessons from the U.S. and the E.U., in M Faure and X Zhang, *Competition Policy and Regulation: Recent Developments in China, Europe and the US*, (Edward Elgar Publishing Ltd, 2011), pp.262-280.

¹⁶⁷ See J F Stewart *et al.*, The Role of Market Structure in Merger Behavior, (1984) Volume 32 No.3, *The Journal of Industrial Economics*, pp 293-312; G J Werden, Assigning Market Shares, *supra* note 9, pp.67-104.

¹⁶⁸ For the meaning of HHI, refer to *supra* note 19.

¹⁶⁹ Announcement of MOFCOM [2011] No.90, *Seagate/Samsung*.

¹⁷⁰ Q Yang and M Pickford, Safe Harbours in Merger Guidelines: What Should They Be?, (2011) volume 44, no. 1, *the Australian Economic Review*, pp.13-35; G J Werden, Assigning Market Shares, *supra* note 9, pp.67-104.

change of concentration level in market is minimal.¹⁷¹ The scope of safe harbour could be smaller in China than in the EU. The intervention of non-competitive factors cannot be monitored in the space of immunity.¹⁷² However, such scope should not be too small, as China is a developing country; the extent of concentration in majority industries is low.¹⁷³ Therefore concentration between small- or medium-sized enterprises could be welcomed currently.¹⁷⁴ However, there is a range of points which should be considered in implementing the safe harbour standard in future: 1) the indexes of HHI and market share should be based on the definition of ‘relevant market’. Yet this definition cannot be precise in most conditions. 2) Transactions outside the scope of safe harbour can also be cleared because of the presence of countervailing effects; 3) mergers within the safe harbour zone are not a definite excuse for exemption from merger review. There are still special circumstances.¹⁷⁵ Therefore a safe harbour can only be a reference for identifying anti-competitive effects. In order to ensure legal certainty challenges to ‘safe harbour’ should be clarified by the MOFCOM in a published decision.

With regard to EU experience, in addition to high market share, assessment should also include whether customers have the possibility to switch suppliers;¹⁷⁶ whether

¹⁷¹ Q Yang and M Pickford, *ibid.*

¹⁷² See D Yu *et al.*, Research on the Safe Harbor Rules in the Horizontal Mergers & Acquisitions Antimonopoly Regulation, [横向并购反垄断规制中的安全港规则研究, Hengxiang Binggou Fanlongduan Guizhizhong de Anquangang Guize Yanjiu], (2010) Volume 46, Issue 3, *Industrial Economics Research*[产业经济研究, *Chanye Jingji Yanjiu*], pp.70-76.

¹⁷³ *Ibid.*

¹⁷⁴ Hence Yu advises that 1) the MOFCOM is unlikely to identify horizontal competition concerns in a market with a post-merger HHI below 1,000. Such markets normally do not require extensive analysis; 2) the MOFCOM is also unlikely to identify horizontal competition concerns in a merger with a post-merger HHI between 1,000 and 2,000 and a delta below 200, or a merger with a post-merger HHI above 2,000 and a delta below 100. D Yu, Y Qiao and W Zhang, *ibid.*

¹⁷⁵ a) A merger involves a potential entrant or a recent entrant with a small market share; b) one or more merging parties is an important innovator in ways not reflected in market share; c) there are significant cross-shareholdings among the market participants; d) one of the merging firms is a maverick with a high likelihood of disrupting coordinated conduct; e) indication of past or ongoing coordination or facilitating practices are present; f) one of the merging parties has a pre-merger market share of 50% or more. These situations are provided pursuant to Paragraph 20, Guidelines on Horizontal Mergers of the EU, *supra* note 1.

¹⁷⁶ For instance, in China’s beer market, brand loyalty deters the switch between products. After concentration the entity would own some of the most popular global beer brands, such as InBev’s Stella Artois and Anheuser-Busch’s Budweiser. See X Zhang and V Zhang, Chinese Merger Control: Patterns and Implications, (2010) Volume 6 Issue 2, *E.C.L.R.*, 485.

competitors are likely to increase supply if price increases;¹⁷⁷ and whether the merged entity is able to hinder expansion by competitors. In addition, market entry and buyer power will be considered countervailing effects to unilateral effects.¹⁷⁸

4.2.3 Focus on the substitution of merging products in the relevant Market

In a highly differentiated product market the market shares of the various products may not indicate constraints on competitors.¹⁷⁹ According to the experience of the EU, customers consider products differently according to brand, quality or the products' geographic location of sales.¹⁸⁰ The MOFCOM should survey the closeness of merging parties, especially when notifying parties argue that they are not the closest competitors in the market. Approaches of investigation contain market studies and consumer surveys, panel data on a sample of consumers and internal documents of merging parties and their rivals.¹⁸¹ Ineffective judicial review cannot correct the error of merger decisions.¹⁸² In order to ensure the rightness of anticompetitive assessment the MOFCOM is advised to use more than one kind of market survey and see if these methods lead to the same result. An economic

¹⁷⁷ Some regions in China are notorious for local protectionism of their beer markets. Beer is sold to consumers through a special distribution system. Breweries sell beer to distributors which in turn sell to retailers. The distributors' contracts with brewers contain territorial limits and prohibit the distributors from selling beer outside their respective territories. Because the distributors cannot sell a brewer's products outside their territories without violating their contracts with the brewer, brewers can charge different prices in different regions for the same package and brand of beer, and individual distributors (and retailers) cannot defeat such price differences through arbitrage. Therefore local protectionism would prevent market entry from outside territory when the local price of beer increased. Evidence of local protectionism can be seen in the Report on Development Strategy of Beer Industry in China 2008, in which the beer market situation in seven districts was illustrated. Specific analysis of local protectionism was discussed in '4.3.1.1 Barriers of Accessing into Some Administrative Zones' in Chapter 1. Report on Development Strategy of Beer Industry in China 2008, see *supra* note 114.

¹⁷⁸ Countervailing market entry and buyer power will be further discussed in Chapter 5.

¹⁷⁹ A Coscelli and S Baker, The role of market shares in differentiated product markets, *supra* note 35; G J Werden, Simulating the effects of differentiated products mergers: a practical alternative to structural merger policy, *supra* note 24, pp.363-386.

¹⁸⁰ A Coscelli and S Baker, *ibid.*, 419;

¹⁸¹ See '2.2 Merging Firms Are Close Competitors' in this chapter.

¹⁸² The MOFCOM's function in implementing non-competitive policy has been discussed in '4.3.2.2 Mission of Implementing Non-competitive Considerations' in Chapter 1.

approach should be used with caution when the results of different market surveys are divergent.

4.2.4 Competitors are Unlikely to Increase Supply if Price Increases

The MOFCOM should additionally evaluate the incentive of competitors to increase supply if they have the ability to do so. According to the experience of the EU, if the expansion of capacity is not costly and not binding by any quota or treaty constraints, the actual rivals may have an incentive to expand output to gain more market share from economies of scale. Therefore, in addition to market structure, the MOFCOM should also investigate competitors' marginal costs of production and quotas of manufacture.¹⁸³ Once competitive constraint from rivals is available a merger might be cleared outright. The MOFCOM should reveal why it considers a competitive constraint from rivals is likely and sufficient in clearance decision.

4.2.5 Merged Entity Able to Hinder Expansion by Competitors

According to the experience of the EU a merged entity is able to hinder expansion by competitors through control of supply of inputs or distribution possibilities, control of intellectual property rights and interoperability between infrastructures.¹⁸⁴ Once these occur they will make the anticompetitive effect of a merger more likely. The MOFCOM should be careful that a proposed transaction will not raise anti-competitive concerns, although merging parties have market power in the procurement market or distribution channel. Reasons include, firstly, that merger does not substantially enhance monopsony of merging parties. The merged entity still lacks the ability and/or incentive to procure materials from its own upstream entity exclusively and foreclose access of other upstream suppliers to a sufficient customer base;¹⁸⁵ secondly, the suppliers of the merged entity might

¹⁸³See Section '2.3.2 Incentive to Expand Output' in this chapter.

¹⁸⁴ See above '2.4 Merged Entity Able to Hinder Expansion by Competitors' in this chapter.

¹⁸⁵ *Seagate/Samsung* in the EU is an example. See discussion in Section 3.4 Merged Entity Able to Hinder Expansion by Competitors. Case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3.

own ‘must have brands’; foreclosure strategy would not significantly harm suppliers’ business. On the other hand the market power of the merged entity is reflected in controlling patent or IP rights. If the market has enough pipeline products or is characterised as active innovation, rivals can realise expansion through developing pipeline products or upgrading their products.

In addition to countervailing factors, the efficiency created by merger can offset its anticompetitive effects. The MOFCOM should clarify the welfare standard for evaluating efficiency. It is recommended that consumer interests are set as the exclusive welfare standard in merger assessment. Since the MOFCOM is a government department, lobbies from domestic enterprises, especially SOEs, can mostly work.¹⁸⁶ Under the lobbying of the domestic rivals the concentration bringing efficiency to competitors might be cleared, although the interest of consumers will be harmed. On the other hand concentration promoting consumer welfare will be prohibited or significant commitments might be imposed if it harms competitor interest.¹⁸⁷ Nor are there are guidelines on the scope of producer welfare and how to quantify or qualify producers’ welfare, which will be influenced by the concentration. The extent of transparency and accountability of merger assessment cannot be improved in the foreseeable future. Under consumer welfare standard the efficiency defence should be of benefit to consumers. Gains

¹⁸⁶ P Ying, The Reasons for Antitrust Merger Control: A Undetermined Standpoint [经营者集中反垄断规制的理由:一个不确定的立场, *Jingyingzhe Jizhong Fanlongduan Guizhi de Liyou: Yige Buqueding de Lichang*], (2009) Volume 2, *Anhui University Law Review* [安徽大学法学评论, *Anhui Daxue Faxue Pinglun*], pp.66-74; P Ying, The Welfare Standards of Anti-monopoly Control on Concentration of Business Operators: A Comparison Study and the Choice of China [经营者集中反垄断控制的福利标准-类型化之研究及我国的选择, *Jingyingzhe Jizhong Fanlongduan Kongzhi de Fuli Biaozhun-Leixinghua zhi Yanjiu ji Woguo de Xuanze*], Volume 4 (2010), *Journal of Lanzhou Commercial College*[兰州商学院学报, *Lanzhou Shangxueyuan Xuebao*], pp.114-121.

¹⁸⁷ Detriment to the interest of competitors does not necessarily harm competition. If the influence on competitors does not affect competition, the concentration should be approved. See : D Spector, From Harm to Competitors to Harm to Competition: One more effort, Please!, (2006) Volume 2, *European Competition Journal*, pp.145-184; E. T. Waine, "Competition, Not Competitors', Nor Canards: Ways of Criticizing the Commission, (2002) Volume 23 Issue 3, *University of Pennsylvania Journal of International Economic Law*, pp.597-636; E. M. Fox, We Protect Competition, You Protect Competitors, (2003) Volume 26 Issue 2, *World Competition*, pp.149-165.

of producer welfare should be passed on to consumers after the merger. This avoids ‘political lobbying’ of domestic rivals for their own interests.¹⁸⁸

To sum up, when the MOFCOM finds the possibility of a merged entity which is able to hinder expansion by its competitors, it should early signal its concern to the notifying parties. The parties could provide views and even evidence in order to allay the MOFCOM’s concerns. In the meanwhile the MOFCOM should investigate the market structure of the upstream supplying market in order to make a judgment on whether a monopsony of a merged entity exists.

4.2.6 Eliminate a ‘Maverick’ Firm

Even if merging parties have no significant market share the MOFCOM still needs to consider their power of innovation or whether there are recent entrants, especially when the market is already concentrated.¹⁸⁹ Because decisions of clearance are not published the public does not know if there is any false positive decision due to failure to consider the effects of a ‘maverick’ firm. In addition, if the relevant market of merging parties is the innovation market, the MOFCOM should conduct some adjustments based on normal merger assessment.¹⁹⁰ Firstly, advanced technology of the merged entity at present does not indicate its power in the future. Customers might switch to rivals with upgraded products even if the merged entity has a relatively high market share. Therefore the MOFCOM should

¹⁸⁸ Comparing protection of total welfare standard, less notified mergers will be approved under the aim of protecting consumer welfare. This is conflict with the aim of ‘relaxing concentration’ in order to increase the GDP of a developing country like China. However, involving industry policy in anti-monopoly assessment has been proved to mess up the market even in times of economic crisis. Therefore, in order to limit the ‘lobby’ effect and special relationship between the government and domestic firms, the consumer welfare standard is more suited to adoption in China, currently at least. Besides, the adoption of total welfare will increase the risk of conflicting with other jurisdictions. See Y Liu, 欧盟企业合并审查中的效率分析 [Efficiency Assessment in Merger Review of the EU, Oumeng Qiye Hebing Shengcha zhong de Xiaolv Fenxi], (2008) Volume 12, *政治与法律*[*Political Science and Law, Zhengzhi Yu Falv*], 151.

¹⁸⁹ For assessment of ‘maverick’ firm see sections 2.5 and 3.5 of this chapter.

¹⁹⁰ An innovative market can be identified by the degree of recent instability of market shares, the rate of growth of the market and estimates of the rate of technological change. See OECD, Merger Review in Emerging High Innovation Markets, DAF/COMP(2002)20, 9.

investigate the human capital and intellectual property of the merged entity which it could use to hinder the innovation of its rivals.¹⁹¹

In conclusion, merger assessment on unilateral effects in China can be improved from the following aspects: firstly, the MOFCOM should continue changing its competitive assessment from a focus on market structure to the effects of concentration on market competition; secondly, reasoning should be made explicit and public as experience of case review increases; thirdly, more measures should be adopted in order to fully protect communication between the antitrust authority, notifying parties and third parties.

4.2.7 Improving Communication amongst the MOFCOM, Notifying Parties and the Third Parties¹⁹²

Unlike that of the EU the MOFCOM's merger assessment is not comprehensive. In *Seagate/Samsung* the market power of the merging parties in the upstream market was not analysed. The MOFCOM did not reveal its opinions on factors which might have had countervailing effects on anti-competitive concerns; for example, the merging parties were not the closest competitors in *Seagate/Samsung*.¹⁹³

The MOFCOM should be made responsible for its incomplete investigation. Nevertheless, rivals of merging parties who might be affected by a merger will report neglected anti-competitive concerns to the MOFCOM in order to secure their own interests. The notifying parties would commit to advocate countervailing factors in order to ensure approval.

¹⁹¹ See above 2.5 Merger eliminates an important competitive force.

¹⁹² Notifying parties are persons or undertakings submitting a notification on merger review; Third party means natural or legal persons considered to have a 'sufficient interest' in merger review and include customers, suppliers and competitors, members of the administrative or management bodies of the undertakings concerned or the recognised representatives of their employees; consumer associations, where the proposed concentration concerns products or services used by final consumers. See Article 11 of the Commission Regulation (EC) No 802/2004 of 7 April 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the Implementing Regulation).

¹⁹³ The neglect of countervailing factors was shown in comparison of case decisions of the EU and China in '3.2 Merging firms are close competitors' in this chapter.

In the EU the European Commission and notifying parties have opportunities for communication. During pre-notification discussions are held in strict confidence between the DG Competition and notifying parties.¹⁹⁴ This provides DG Competition and the notifying parties with the possibility, prior to notification, to discuss jurisdictional and other legal issues. They also provide an opportunity to discuss issues such as the scope of the information to be submitted, and to prepare for the forthcoming investigation by identifying key issues and possible competition concerns (of harm) at an early stage.¹⁹⁵ Within 15 days of notification the Commission will offer ‘state of play’ to the notifying parties.¹⁹⁶

In Phase II investigation communication between the notifying parties and the Commission is mainly based on the ‘statement of objections’.¹⁹⁷ Pursuant to the ‘state of play meetings’ in Best Practice, notifying parties will be offered the first time of meeting normally within two weeks of the initiation of the second phase of investigation in order to discuss, inter alia, the Commission’s competition concerns raised by the proposed concentration and the approximate timetable of the second phase procedure.¹⁹⁸

The second meeting will typically be scheduled before the issuing of the statement of objections (hereafter ‘SO’), in order for the notifying parties to be informed of the Commission’s view resulting from the investigation. The experience of the EU is that the SO can be succinct, but should be very clear in order to express the Commission’s views and facts on which it relies.¹⁹⁹ It is sometimes not until the SO has been sent that the notifying parties know what the Commission’s real concerns

¹⁹⁴ See Paragraph 8, DG Competition Best Practice on the conduct of EC merger control proceedings (Best Practice), 20/01/2004, available at: <http://ec.europa.eu/competition/mergers/legislation/proceedings.pdf> (accessed 24th September 2013).

¹⁹⁵ The purposes of pre-notification contacts refer to point 3, Best practice, *ibid*, 2.

¹⁹⁶ Paragraph 6, Best Practice, *ibid*.

¹⁹⁷ The Statement of Objections will set out all the facts and law on which these objections are based, and the defendant parties must comment not only on these objections but also on the evidence on which the Commission relied in formulating its objections on. See note 12 in M Kekelekis, the ‘statement of objections’ as an inherent part of the right to be heard in EC merger proceedings: issues of concern, (2004) Volume 25 Issue 8, *E.C.L.R.*, pp. 518-527.

¹⁹⁸ Point 33-b), Best Practice.

¹⁹⁹ M Kekelekis, *ibid*, 524, see also paragraph 9, case C-45/69 *Boehringer Mannheim v Commission* [1970], *E.C.R.*, 769.

are.²⁰⁰ Regarding the SO, the notifying parties could make known their views on every document used by the Commission to support its anti-competitive concerns. In the EU the defendants' right to be heard is absolute.²⁰¹ They can submit their observations in writing or present their case at the oral hearing.²⁰² The Commission is not entitled to base its arguments on documents and figures based on confidential information that are not going to be made available to the notifying parties.²⁰³ In other words the Commission must base its decision only on objections on which the parties have been able to submit their observations.

A third meeting is to be offered following the parties' reply to the Statement of Objections and/or the oral hearing, which will mainly serve as an opportunity to discuss possible remedial proposals.²⁰⁴ A last meeting will be offered before the Advisory Committee, enabling the notifying parties to discuss with the Commission the result of the latter's market test of the remedies proposed and formulate improvements if necessary.²⁰⁵

In China, until the *Coca-Cola/Huiyuan* decision the full procedures of hearings were not defined.²⁰⁶ Prior to formal notification merger parties could apply to

²⁰⁰ See M Kekelekis, *ibid*, 525.

²⁰¹ See Article 13, the Implementing Regulation, *supra* note 192.

²⁰² See Article 13 (3) and (4), *ibid*.

²⁰³ In *Telefunken v. Commission*, the court revealed that 'Since these documents were not mentioned in the Statement of Objections, Aeg was entitled to take the view that they were of no importance for the purposes of the case. By not informing the applicant that these documents would be used in the decision, the Commission prevented Aeg from putting forward at the appropriate time its view of the probative value of such documents. It follows that these documents cannot be regarded as admissible evidence for the purpose of this case.' See paragraph 27, Case C-107/82 *Telefunken v. Commission*, [1983] E.C.R., II-3151, and see also note 18 in M Kekelekis, *The EC Merger Control Regulation: Rights of Defence*, (Netherlands, 2006), 149.

²⁰⁴ Point 33 (d), Best Practice, *supra* note 194.

²⁰⁵ See Paragraphs 23-41, Best Practice, *ibid*. There is not much secondary literature dealing exclusively with the Commission's investigatory power and the parties' rights involved during the preliminary investigation procedure under the EUMR. Most of it is related to the practices under Regulation 17. It must be stressed that none of the secondary literature does more than simply present a description of the preliminary investigation procedure and related case law. Citing from note 3 in M Kekelekis, *The EC Merger Control Regulation: Rights of Defence*, (Kluwer Law International, 2006), 111. The cited Regulation No 17: First Regulation implementing Articles 101 and 102 of the Treaty changed into Council Regulation (EC) No 1/2003 on 16 December 2002.

²⁰⁶ The standpoint here serves for the enforcement authority to conduct more complete investigation rather than for the better protection of the rights of notifying and third parties particularly. In *Coca Cola/Huiyuan*, during the merger review, there was no hearing procedure available, and consumers' opinions were not fully heard. See D Wei, *China's Anti-monopoly Law and Its Merger Enforcement*:

discuss related issues of notification with the MOFCOM.²⁰⁷ The consultative process might increase the transparency and certainty of the merger review and might provide the parties with a ready mechanism by which to dispose of transactions that raise few competition concerns. Undertakings are allowed to submit written statements and arguments regarding their notifications. The MOFCOM must consider those materials.²⁰⁸ The MOFCOM has also enhanced its communication system by using its website to update applicants on the status of each merger filing.²⁰⁹

When a merger review enters Phase II, there is bilateral meeting between the MOFCOM and notifying parties on the ‘Statement of Objections’.²¹⁰ However, the views in the SO have no links with the facts on which the MOFCOM relies in the final decision. The concerns and facts on which the MOFCOM relies in the final decision are not compulsorily to be all checked and reviewed by the notifying parties. In other words the MOFCOM could base its decision on objections on which the parties have not been able to submit their observation. As judicial review in China is ineffective, the notifying parties can hardly challenge those concerns and materials for merger decision in future.²¹¹ The notifying parties should be entitled

Convergence and Flexibility, (2011) Volume 14 Issue 4, *Journal of International Economic Law*, 818. The procedure of hearing is regulated in article 7, Review Measures, *supra* note 157.

²⁰⁷ See article 8, Ministry of Commerce of the People's Republic of China, Announcement No.11 of 1st January 2010, Measures for Notification of Concentrations of Business Operators (the “Notification Measures”). According to Articles 25 and 26 of the AML 2008 merger review in China can have two phases. The Anti-monopoly Authority I conducts a preliminary review of the declared concentration and takes a decision whether to initiate a further review within 30 days. If the Anti-monopoly Authority under the State Council decides not to carry out further review or fails to take a decision at expiry of the stipulated period, the concentration may be implemented. If the Anti-Monopoly Authority decides to carry out a further review, it must inform the parties to the transaction of this in writing. The Anti-monopoly Authority has 90 days to carry out a further review. However, phase II can be extended by up to 60 days if the business operators concerned agree to extend the time limit; or the documents or materials submitted are inaccurate and need further verification; or things have significantly changed after declaration.

²⁰⁸ See Article 5, Review Measures, *supra* note 157.

²⁰⁹ The notifying parties are given a password to view the status of their filings on the MOFCOM's website at: <http://xzsw.mofcom.gov.cn> (visited on the 27th April 2013).

²¹⁰ Article 10 of Review Measures states: ‘In the further review stage, if the MOFCOM considers that the concentration of undertakings has or may have the effect of eliminating or restricting competition, it shall inform the undertakings participating in the concentration of its statement of objection, and set a reasonable deadline within which the undertakings participating in the concentration may submit their defense in writing’. Review Measures, *supra* note 157.

²¹¹ The ineffectiveness of judicial review in China has been proved in ‘4.3.3 Ineffectiveness of Judicial Review’ in Chapter 1.

to make known their views on every document used by the MOFCOM as evidence of the existence of anti-competitive concern. The MOFCOM should base its decision only on objections raised in the SO. Communication concerning the SO should be compulsory in cases raising significant anti-competitive concerns.

b. Communication between the MOFCOM, Notifying Parties and Third Parties

In addition to bilateral communication between merging parties and the Commission, DG Competition may also decide to invite third parties and the notifying parties to a ‘triangular’ meeting, when DG Competition believes it is desirable.²¹² When merger assessment proceeds to Phase II of investigation, DG Competition may, in the interest of the investigation, in appropriate cases provide third parties that have shown a sufficient interest in the procedure with an edited version of the SO, with business secrets removed, in order to allow them to make their views on the Commission’s preliminary assessment known.²¹³ DG Competition may also invite third parties to meetings to discuss and clarify specific issues raised in the formal oral hearing in Phase II.²¹⁴ Third parties are also entitled, upon application, to be heard, and the Commission must inform them in writing of the nature and subject matter of the procedure and fix a time limit within which they may make their views known in writing.²¹⁵

However, communication between the MOFCOM, notifying and third parties in merger assessment has a number of drawbacks not disclosed in the EU system. Firstly, decisions will not be published if the concentration notified does not fall within the scope of merger control.²¹⁶ The voices of objection from third parties to these transactions cannot be heard by the MOFCOM. The MOFCOM does not declare its acceptance of a notification. Third parties have no chance to initiate a hearing

²¹² See paragraphs 38 and 48, Best Practice, note 194 *supra*; the right is also set out in Article 16 of the EUMR; and Articles 14 -16 of the Implementing Regulation, note 193 *supra*.

²¹³ In such cases the SO is provided under strict confidentiality obligations and restrictions of use, which the third parties have to accept prior to receipt. Section 7, Best Practice, *supra* note 194.

²¹⁴ For more information on third parties’ right to a hearing see paragraph 35, Best Practice, *ibid*.

²¹⁵ See article 16 of the Implementing Regulation, *supra* note 193.

²¹⁶ For standard of notification see Article 3, the State Council Order No.529, Provisions of the State Council on the Standard for Declaration of Concentration was promulgated on the 3rd August 2008.

unless the MOFCOM consults them in the investigation.²¹⁷ In addition, further review notifications only inform the business operators of the transaction. Therefore third parties do not know whether transactions are proceeding to Phase II investigation.²¹⁸ They have no chance to apply for a formal oral hearing. The Statement of Objections is not issued to third parties.²¹⁹ Other than by invitation from the MOFCOM third parties have no opportunity to discuss their views with the MOFCOM. The MOFCOM is not capable of thinking of all related third parties in merger review. In *Inbev/AB* the consumers in Wenzhou City had no opportunity to express their views, even though they might have been affected by the merger. In Wenzhou City of Zhejiang Province the corporations Inbev and AB had intense competition in the relevant market for beer. In order to take a greater market share, they competed to produce better beer at a lower price. Consumer welfare was secured by the competition. Reducing competition between them might have an effect on the interest of consumers in this district.²²⁰ Nevertheless, as the enforcement authority did not invite representatives of the Wenzhou Consumer Association to merger proceedings, their views on the merger were not heard in the merger review.

In order to collect all the information which may be important for its decision, third parties should have the opportunity actively to submit their comments on the proposed concentration. Once a merger notification is accepted the MOFCOM should publicly post a notification on concentration on its official website.²²¹ This

²¹⁷ According to Article 6 of the Review Measures, during review the MOFCOM may seek opinions from entities or individuals such as relevant government authorities, industry associations, undertakings and consumers when necessary. The Review Measures, *supra* note 157.

²¹⁸ If the MOFCOM considers a further review necessary, a decision to conduct a further review will not inform the third parties and the public. According to Article 9 of the Review Measures, if the MOFCOM considers a further review is necessary, a decision to conduct a further review shall be made, and the notifying parties shall be informed in writing. The Review Measures, *ibid*.

²¹⁹ According to Article 10 of the Review Measures the MOFCOM only needs to inform the undertakings participating in the concentration of its statement of objection if it considers that the concentration of undertakings has or may have the effect of eliminating or restricting competition. The Review Measures, *ibid*.

²²⁰ W Sheng, Looking through the war of beer between Shuanglu and Budweiser [从品牌角度看双鹿与百威的啤酒之战, *Cong Pinpai Jiaodu Kan Shuanglu Yu Baiwei de Pijiu Zhi Zhan*], (2006) Volume 2, *Management and administration* [经营与管理, *JingyingyuGuanli*], 37.

²²¹ An example of the EU model on prior notification of a concentration is available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:195:0023:0023:EN:PDF> (accessed on the 3rd February 2013).

notification may include the names of the persons concerned and the type of concentration. This may allow interested parties to provide information and request a hearing within a certain period. In addition, in order for the MOFCOM to be able appropriately to evaluate the information contained in the notification form and effectively assess the compatibility of the notified concentration within the relevant market, third parties' observations should be respected. Third parties are entitled to receive a copy of a non-confidential version of the statement of objections, enabling them to provide necessary information regarding the impact of a concentration on their interests.

Chapter 4: Horizontal Mergers-- Coordinated Effects

1 Introduction

1.1 Concept of Coordinated Effects

Apart from unilateral effects a horizontal merger may raise another type of anti-competitive concern. Tacit or explicit collusion between remaining firms in the market becomes more likely through a reduction of competitors or a change in market structures post-merger. Such effect is known as the coordinated effect of merger.¹ Once coordinated effects occur they reduce internal competition between coordinating firms. These can raise their prices above the competitive level without considering the interruption from fringe rivals, buyers and customers. This is a collective dominance (dominant oligopoly) situation, and is detrimental to consumer welfare. Collective dominance is based on ‘modern oligopoly theory’.² In game theory each player can be better off if they cooperate with other players. However, the profit of every firm cannot be maximised in collusion. Each player can earn more individually if they deviate from the common agreement and undercut the agreed monopoly price. The risk is that the short-run gain from deviation in the form of temporarily higher prices may be countervailed by the longer-term losses that would result from the ensuing price war once other

¹See Section 2 in National Economic Research Associates, *Merger Appraisal in Oligopolistic Market*, (November 1999), Prepared for the Office of Fair Trading, available at: http://www.offt.gov.uk/shared_offt/reports/comp_policy/oft267.pdf (accessed on the 23rd September 2013).

²The economic models of collective monopoly contain Game Theory and the Prisoners’ Dilemma. see M Ivaldi et al., *the Economics of Tacit Collusion*, (March 2003), Final Report for DG Competition, European Commission, available to see at: http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_tacit_collusion_en.pdf (viewed on the 23rd September 2013); H Haupt, *Collective dominance under Article 82 E.C. and E.C. merger control in the light of the Airtours judgment*, (2002), Volume 23 Issue 9, *E.C.L.R.*, pp.434-444; European Economics, *Study of Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control*, (May 2001), Final Report for the European Commission Enterprise Directorate General, available to see at: http://ec.europa.eu/enterprise/newsroom/cf_getdocument.cfm?doc_id=2683 (accessed on the 23rd September 2013); D TScheffman and M Coleman, *Quantitative Analyses of Potential Competitive Effects from a Merger*, Volume 12 Issue 2, *George Mason Law Review*, 319.

members retaliate by lowering their price. The possibility of punishment may deter firms from deviating.

There are two types of coordination between firms. Explicit coordination is illegal both in the EU and China. It is regulated under Article 101 TFEU and under Chapter 2 of the AML 2008 in China.³ Existing tacit coordination without explicit agreement is legal in the EU and China. Merger assessment refers to predicting market behaviour as a result of changes brought by a concentration, and to blocking mergers which suggest that the outcome will be closer to a collective monopoly. There are various forms of tacit coordination, including coordination on price, coordination on capacity decision,⁴ alignment on customer or market sharing,⁵ multimarket contacts⁶ and bid-rigging.⁷

1.2 Aim and Structure of the Chapter

This chapter considers the approaches of the EU and China in evaluating coordinated effect in a merger.⁸ The first comparison will show which jurisdiction has more advantages in evaluating the coordinated effect of a

³In this thesis collective dominance and dominant oligopoly have the same meaning. The EU Commission also stated that 'the terms collective, joint and oligopolistic dominance are used as synonyms in this decision', see, note 26 in case COMP/M.2498 *UPM-Kymmene/Haindl*, [2002] O.J.L233/38, paragraph 75

⁴ When products are highly differentiated it is hard to reach an agreement on (the same) product price. Firms may be able to agree on capacity at the capacity setting stage or the product selling stage. Prices may be expected to rise by restricting production capacity. See S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, (2004) Volume 49 Issues 1 and 2, *Antitrust Bulletin*, pp. 195-242.

⁵ Effective competition can be reduced if firms tacitly agree not to target each other's customers or areas of the market. This means that each firm will not offer its rivals' customers lower prices, since this will lead to retaliation with its own customers. In this case each firm is able to charge a higher price than the competitive level to its customers. Similarly, market sharing means firms agree to separate the relevant market into several parts. In each one's 'home' area other rivals should not offer lower price to customers. Customer or market sharing may exist when price transparency is low and demand side is relatively concentrated. See S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, *supra* note 4, 205.

⁶ When firms compete in more than one market they may have fewer incentives to deviate. This is because punishment by other competitors will be conducted in more than one market. *Ibid*, 205.

⁷ Robert and Hudson state that coordination takes four forms: price-fixing, capacity co-ordination, market sharing and bid rigging. See G Robert and C Hudson, Past co-ordination and the Commission Notice on the appraisal of horizontal mergers, (2004) Volume 25 No.3, *E.C.L.R.*, pp. 163-168.

⁸ In the following coordination means only tacit collusion.

merger; the second which jurisdiction offers greater transparency of merger assessment to the public.⁹

This chapter is divided into three parts: it first examines the approaches for assessing the coordinated effects of horizontal mergers in the EU historically. Second, China's approach will be reviewed. Given the results of comparison, this chapter then offers some recommendations on assessment of coordinated effects in China. These suggestions concern : 1) how better to assess the coordinated effects of horizontal mergers on the competitive process, and 2) how to clarify merger assessment more transparent to the public through legislation and case decisions.

2 Assessment of Coordinated Effects in EU Merger Control

2.1 Checklist Period

2.1.1 General Checklists

In 1992 in *Nestlé/Perrier* the Commission decided to include oligopolistic market under the Merger Regulation.¹⁰ The Commission cleared *Nestlé/Perrier* with commitments because it would create collective dominance post-merger.¹¹ The market characteristics raising concerns of coordinated effects include that the remaining market players were similar in respect of their size and nature, their

⁹The reasons for choosing these two analytical standards have been revealed in Chapter 1.

¹⁰ Before this case the Commission had taken the view that the EU Merger Regulation does apply to oligopolistic dominance. See C Olsson, *Collective Dominance - Merger Control on Oligopolistic Markets*, (2001), 16, available at: <https://gupea.ub.gu.se/bitstream/2077/2124/1/200105.pdf> (Accessed on the 22nd 2013). In light of previous legal and economic experience Article 2 (3) of EUMR 1989 was interpreted as covering both single firm and oligopolistic dominance. See paragraph 115, Case IV/M.190 *Nestlé/Perrier*, [1992] O.J. L 356/1. The Court of Justice of the European Union (CJEU) also approved the Merger Regulation applying to cases involving a collective dominant position. See paragraph 163, Joined Cases C 68/94 and 30/95 *France v. European Commission* [1998] E.C.R. I-1375., EUMR 1989 means Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, [1989] O.J. L395.

¹¹ Post-merger, Nestlé has undertaken to divest part of its brand names and capacity to other competitors. Case IV/M.190 *Nestlé/Perrier*, [1992] O.J. L 356/1, point 136.

capacities and their market shares.¹² In 1997 the court clarified that merger control should focus exclusively on whether a merger will increase the feasibility of coordination or tacit collusion. Explicit collusion will have to be assessed under Article 101 TFEU.¹³ In the following year experience in assessing coordinated effect increased. The General Court explicitly indicated the possibility of retaliatory measures' being necessary to enforce compliance of members of an oligopoly with certain collusive market behaviour.¹⁴ The following gives an overview of the checklists considered by the Commission.

First of all the Commission appears to apply an initial screening test based on the number of significant firms and their combined market share.¹⁵ Early cases suggested that the Commission drew the line at three-to-two mergers. *Airtours/First Choice* was the first case which the Commission prohibited a merger that would have left three major firms in the market post-merger.¹⁶ In the *Price Waterhouse/Coopers* case the Commission set a tentative upper bound of coordination post-merger at four players:

From a general viewpoint, collective dominance involving more than three or four suppliers is unlikely simply because of the complexity of the

¹² Case IV/M.190 *Nestlé/Perrier*, [1992] O.J.L356/1, paragraphs 119-130.

¹³ This was the first proposed merger which was prohibited under the Merger Regulation on the grounds of collective dominance. Although an appeal was lodged, the General Court (European Union) (ex Court of First Instance) eventually upheld the Commission's decision in its entirety. See Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraph 164. The case came on appeal before the General Court see Case T-102/96 *Gencor v. European Commission* [1999] E.C.R. II-753. Discussion of this case is available at C Caffarra and J Ysewyn, Two's company, three's a crowd: the future of collective dominance after the Kali and Salz judgment, (1998) Volume 19 Issue 7, *E.C.L.R.*, pp. 468-472; S Bishop, Power and responsibility: the CJEU's Kali-Salz judgment, (1999) Volume 20 Issue 1, *E.C.L.R.*, pp. 37-39.

¹⁴ See Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraph 158.

¹⁵ This is according to the structural assumption of oligopoly analysis, namely that the fewer the market players, the higher the likelihood of collusion. See note 8 in F Polverino, Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis, (2006), SSRN working paper, 8, available at: <http://ssrn.com/abstract=901688> (Accessed on the 22nd September 2013).

¹⁶ European Economics, Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control, *supra* note 2, 3.

interrelationships involved, and the consequent temptation to deviate; such a situation is unstable and untenable in the long term.¹⁷

To sum up, the Commission does not clarify how few are few.¹⁸ The indication of market structure is taken as the primary consideration in the checklist approach.¹⁹ Nevertheless, there are exceptional conditions where market coordination remains unfeasible, notwithstanding a high level of concentration. One example is where a merger generates efficiency and creates a ‘maverick’ firm with more power than other firms.²⁰ In such a case fewer competitors would decrease rather than increase the coordination of the market.²¹

The second pro-coordination market characteristic is the homogeneity of products. The Commission concludes that it is easier to coordinate price for a single, homogeneous product, than for hundreds of prices in a market with many differentiated products.²² However, evidence of parallel prices is not conclusive of coordination. Intense competition can still lead to similar prices among firms.²³ In order to ease confusion the European Commission suggests analysing the

¹⁷ Case IV/M.1016 *Price Waterhouse/Coopers and Lybrand*, [1999] O.J. L50/27, paragraph 103. The Commission cleared the transaction because there would be five players remaining in the industry in little danger of collective dominance post-merger.

¹⁸ Scholars object that the concept of collective dominance does not only imply duopolies. Conversely, even the ‘duopoly’ standard has its exceptions. In markets characterised by bidding competition it is possible that even two firms are sufficient for effective competition. See C Caffarra and J Ysewyn, *Two's company, three's a crowd: the future of collective dominance after the Kali and Salz judgment*, *supra* note 13, pp. 470-471.

¹⁹ J B Baker, *Mavericks, Mergers and Exclusion: Proving Coordinated Competitive Effects under the Antitrust Laws*, (2002) Volume 77 Issue 1, *New York University Law Review*, 135.

²⁰ According to Guidelines on Horizontal Mergers a ‘maverick’ firm is a kind of enterprise that can prevent or disrupt coordination, ‘for example by failing to follow price increases by its competitors, or has characteristics that gives it an incentive to favour different strategic choices than its coordinating competitors would prefer’. See paragraph 42, Guidelines on Horizontal Mergers.

²¹ See F Polverino, *Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis*, *supra* note 15, 12.

²² Paragraph 45, Guidelines on Horizontal Mergers. A homogeneous product is one indication that there will be no effective competition between merging parties. See Case No IV/M.308 *Kali+Salz/Mdk/Treuhand*, [1994] O.J. L186/38, paragraph 57; Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraph 138; Case No IV/M.1517 *Rhodia/DonauChemie/Albright and Wilson*, [1999] O.J.C 248/10, paragraph 52.

²³ G Robert and C Hudson, *Past co-ordination and the Commission Notice on the appraisal of horizontal mergers*, *supra* note 7, pp. 163-168.

‘profitability and the response of prices to changing demand and supply conditions’ as ways of identifying pre-existing co-ordinated effects’.²⁴

Thirdly, the Guidelines on Horizontal Mergers also suggest that it is easier to coordinate on price when demand and supply conditions are relatively stable than when they are continuously changing.²⁵ In *Gencor/Lonrho* the Commission noted that low price elasticity ‘creates an incentive for anti-competitive parallel behaviour, since all suppliers would lose by engaging in price competition’.²⁶ Stable demand or supplies are conducive to reaching terms of coordination between firms and detecting deviation. In a market with fluctuating demand it is hard to tell whether sales are lost because the level of demand is reduced or because one competitor deviated from the collusion to offer particularly low prices.²⁷

Fourthly, the Commission places considerable weight on any evidence of asymmetry in market shares and cost structures.²⁸ Actually, apart from asymmetry in cost structure, asymmetry is also reflected in remaining competitors’ capacity levels,²⁹ the degree to which the remaining competitors are vertically integrated³⁰ and in the financial power of remaining competitors’ parent companies. Nevertheless, in specific cases the Commission did not consider cost symmetry,

²⁴ In intense competition prices may fluctuate with a change in demand or supply. Nevertheless, in the situation of coordination the agreed price may be stable despite a change in demand or supply. Ibid.

²⁵ Paragraph 45, Guidelines on Horizontal Mergers. Citing cases COMP/M.2097 *SCA/Metsä Tissue*, [2002] O.J. L/ 1, point 148; Case IV/M.1298 *Kodak/Imation*, [1999] O.J.C17/2, point 60.

²⁶ Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraph 151.

²⁷ ICN, Report on Merger Guidelines- Chapter 4 Coordinated Effects Analysis under International Merger Regimes, (April 2004), 18, available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc560.pdf> (accessed on the 18th April 2013).

²⁸ Paragraph 48, Guidelines on Horizontal Mergers. The effects of similarities of cost structure to synergies can be seen in Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraphs 182-183; See also OECD, Oligopoly, Policy Roundtables, October 1999, DAF/CLP(99)25, 81; available at: <http://www.oecd.org/dataoecd/35/34/1920526.pdf> (accessed on the 10th July 2013).

²⁹ Case No IV/M.315 *Mannesmann/Vallourec/Ilva*, [1994] O.J.L102/15, paragraph 64.

³⁰ In *Airtours/First Choice* the vertically integrated nature of the major tour operators particularly distinguished them from fringe operators, Case IV/M.1524 *Airtours/First Choice*, [2000] O.J. L 93/1.

especially when there was other evidence to indicate that coordination was unlikely.³¹

Fifthly, the Commission indicates that structural links such as cross-shareholding or participation in joint ventures may also help in aligning incentives among coordinating firms.³² Examples of structural links include cross-shareholding, third party interest in competing firms, cross-licensing agreements and strategic alliances.³³ Prior to *Kali und Salz* structural links were considered a necessary condition of coordinated behaviour.³⁴ Since *Goncer/Lonrho* links between firms have been regarded only as one factor among others that can help encourage coordinated behaviour.³⁵ In fact the effect of structural links on coordination effect is ambiguous. For example, cross-shareholding may improve the transparency of information between major firms. However, structural links also reduce incentives for retaliation, which can make coordination unsustainable. This example shows that what matters in the evaluation of collective dominance is a causal link showing how structural links create an incentive to collude and how this collusion is sustained by a possible retaliation mechanism, rather than the presence of structural links themselves.³⁶

³¹In the *AKZO Nobel/Hoechst Roussel Vet* case there were three strong competitors in the market with asymmetric market shares. Therefore the cost of structure was not further analysed. See Case COMP/M.1681 *AKZO Nobel/Hoechst Roussel Vet*, [2000] O.J.C11/07, paragraph 94.

³²Paragraph 48, Guidelines on Horizontal Mergers.

³³European Economics, Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control, *supra* note 2, 41.

³⁴The role of structural links between coordinating firms was seen as a necessary condition of raising coordination concern in *Kali und Salz*. In its judgment, the Court asserted that the Commission relied on special links between '*Kali und Sals*' and SCPA to ascertain the likelihood of their parallel behaviour. However, the Commission had not given sufficient reasons for establishing the links it had alleged. Joined Cases C 68/94 and 30/95 *France v. European Commission* [1998] E.C.R. I-1375, paragraphs 227-230.

³⁵See Case T-102/96 *Gencor v. European Commission* [1999] E.C.R. II-753, point 27. See also Case IV/M.1016 *Price Waterhouse/Coopers and Lybrand*, [1999] O.J. L50/27, paragraph 101; Case No IV/M.358 *Pilkington-Technict/SIV*, [1993] O.J. L158/24, paragraph 39. F Polverino, Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis, *supra* note 15, 22.

³⁶ See C Olsson, Collective Dominance - Merger Control on Oligopolistic Markets, *supra* note 10, 25.

Finally, the Commission suggests that coordination is more likely to exist in markets where repeated interaction between firms is frequent,³⁷ the reference point is transparent³⁸ or the technology is mature.³⁹

2.1.2 An Evaluation of the Checklist Approach

Between 1992 and 2004 there was no specific method for assessing coordinated behaviour.⁴⁰ The Commission generally relied too heavily on going through a checklist of factors to decide how they would influence the likelihood of coordinated behaviour. A checklist can be a helpful guide to the factors that should be taken into account. However, the drawbacks of such an approach are also obvious.

Firstly, the outcome is still uncertain in the light of both plus- and minus- market characteristics of tacit collusion. That the ‘pluses’ outweigh the ‘minuses’ in no way implies coordinated effects are to be expected. For example, existing firms are still unlikely to give rise to coordinated effects if a merger in a market fulfils a number of oligopoly-plus factors but is characterised by easy entry or easy expansion as well.⁴¹ Secondly, a checklist approach only offers a static analysis of

³⁷ European Economists note that ‘By setting choice variables such as price, quantity or advertising levels in subsequent periods, firms can find out what triggers an aggressive reaction by rivals and what is met by corporation. Using this trial-and-error method, firms can arrive at a collusive equilibrium without any communication’. See M Ivaldi, the Economics of Tacit Collusion, *supra* note 2, pp. 19-22; European Economics, Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control, *supra* note 2, 22.

³⁸ Paragraph 47, Guidelines on Horizontal Mergers.

³⁹ Paragraph 45, Guidelines on Horizontal Mergers. It is one consideration of the Commission when drawing its conclusions in a case. Even if market concentration is high and there are other facilitating factors such as similar cost structures in the market, the Commission will not oppose a merger on the grounds of heavy RandD and rapid innovation. For example, in *Nestle/Perrier, Kali und Salz* and *Gencor/Lonrho* the maturity of the market was one of several factors inclining the Commission to the same view. See paragraph 126, Case IV/M.190 *Nestlé/Perrier*, [1992] O. J. L 356/1; paragraph 57, Case No IV/M.308 *Kali+Salz/Mdk/Treuhand*, [1994] O.J. L186/38; Paragraph 152, Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30. However, in *Rhodia/Donau* the Commission also found the relevant markets to be mature, though, due to other considerations, it concluded that the merger did not raise competitive concerns. Case No IV/M.1517 *Rhodia/Donau Chemie/Albright and Wilson Rhodia/Donau*, [1999] O.J.C248/10, paragraph 52.

⁴⁰ G Robert and C Hudson, Past co-ordination and the Commission Notice on the appraisal of horizontal mergers, *supra* note 7, 166.

⁴¹ See S Bishop, Power and Responsibility: The ECJ's Kali-Salz Judgment, *supra* note 13, pp.37-39. S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, *supra* note 4, 211.

market characteristics. It cannot show how a merger significantly impedes effective competition or how coordination is predicted to be sustained post-merger.⁴²Thirdly, the Commission does not appear to have placed the various factors in a clear hierarchy.⁴³It has ample discretion to find support for its conclusions. This increases the uncertainty of merger decisions. Fourthly, as discussed above, certain factors have an ambiguous effect on the creation or sustaining of coordination. The Commission does not state clearly how to treat such factors in assessment. All of these factors are contrary to the aim of transparency to the public, and also makes the result of coordinated assessment unpredictable.

2.2 Assessment under a Fixed Framework

Airtours/First Choice represents a significant improvement on the checklist approach commonly used by the Commission. It established a general framework for finding collective dominance.⁴⁴The General Court finally established three cumulative factors in coordination assessment:

Firstly, the market must be transparent enough to allow for monitoring of the other firms' market conduct. Secondly, coordination must be sustainable, which means that the participants must be deterred from defection by fear of

⁴²S Bishop and A Lofaro state that the checklist approach does not address 'how the merger affects the mode of competition other than in the obvious sense of reducing the number of suppliers and changing the distribution of market shares'. S Bishop and A Lofaro, *ibid.*, 197.

⁴³Scholars have discussed the possibility and reasonability of attaching a ranking of criteria to the assessment of coordinated effect. See Section 2.6 Interaction and Relative Importance of the Market Characteristics for Tacit Collusion in European Economics, Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control, *supra* note 2.

⁴⁴Case IV/M.1524 *Airtours/First Choice*, [2000] O.J. L 93/1. The General Court's review of this case is in Case T-342/99 *Airtours v Commission* [2002] E. C. R II-02585. For discussion of the cumulative criteria see S Baxter and F Dethmers, Collective dominance under EC merger control - after *Airtours* and the introduction of unilateral effects is there still a future for collective dominance?, (2006) Volume 27 Issue 3, *E.C.L.R.*, pp. 148-160; M Motta, E.C. merger policy and the *Airtours* case, (2000) Volume 21 Issue 4, *E.C.L.R.*, pp. 199-207; K Kühn, Closing Pandora's Box? Joint Dominance after the "Airtours" Judgment, (June, 2002). Michigan Law and Economics Research Paper No.02-013, 18, Available at: <http://ssrn.com/abstract=349521> (Accessed on the 13th June 2012); A Nikpay and F Houwen, Tour de force or a little local turbulence? A heretical view on the *Airtours* judgment, (2003) Volume 24 Issue 5, *E.C.L.R.*, pp. 193-202; V Rabassa and P Christensen, The *Airtours* decision: is there a new Commission approach to collective dominance?, (2001) Volume 22 Issue 6, *E.C.L.R.*, pp. 227-237.

retaliation. Thirdly, the benefits of coordination must not be jeopardised by the actions of current or future competitors or by customers.⁴⁵

In 2004 an analytical framework for coordinated effect was published in the Guidelines on Horizontal Mergers.⁴⁶ It drew on deliberations in cases such as *Airtours/First Choice* and *Gencor/Lonrho*.⁴⁷ According to the analytical framework four criteria should be fulfilled if the Commission raises coordinated effects in any mergercase.

2.2.1 Reaching Terms of Coordination

First of all ‘coordination is more likely to emerge if competitors can easily arrive at a common perception as to how the coordination should work.’⁴⁸ All market characteristics mentioned in the checklist approach are conducive to reaching a consensus of coordination between remaining firms. However, in order to sustain a merger punishment should be available to deter deviation. Punishment is effective only when deviation can be detected in time. Therefore a monitoring mechanism is necessary. Finally, coordination can be sustained when outsiders have limited power to constrain the price increase of coordinated effect. To sum up, when assessment is made within an analytical framework the Commission pays more attention to how coordination can be operated and sustained in the long term.

⁴⁵Case T-342/99 *Airtours v Commission* [2002] E.C.R II-02585, paragraph 62.

⁴⁶Paragraphs39-57, Guidelines on Horizontal Mergers.

⁴⁷In 2002, the Commission’s three prohibition case decisions were reversed by the General Court. These three prohibition cases are Case T-342/99, *Airtours v Commission* [2002] E.C.R.-II2585; Case T-310/01, *Schneider Electric v Commission* [2002] E.C.R. II-4071 and Case-T-5/02, *Tetra Laval v Commission* [2002] E.C.R. II-4381. This has occasioned the Commission’s concern with improving the certainty of merger assessment on coordinated effect. Another important case in the development of coordinated effect assessment in the EU is *Sony/BMG*. As it was determined in 2004, the same year as the EU Merger Regulation was issued, its influence on the establishment of an analytical framework might be limited. The contribution of *Sony/BMG* to merger assessment is mainly analysed in the following section ‘2.4.2 The Standard of Proof’ in this chapter.

⁴⁸Paragraph 44, Guidelines on Horizontal Mergers.

2.2.2 *Monitoring Deviations*

Coordinating firms are often tempted to increase their share of the market by deviating from the terms of coordination, for instance by lowering prices, offering secret discounts, increasing product quality or capacity or trying to win new customers. Only the credible threat of timely and sufficient retaliation prevents firms from deviation.⁴⁹ Market transparency is necessary in order to monitor whether other firms are deviating, and thus know when to retaliate. Transparency in the market is often higher when it has fewer active participants.⁵⁰ Transparency also depends on how market transactions take place in a particular market. Transactions taking place by public exchange or at an open auction are more transparent than those conducted in confidential negotiation between buyers and sellers on a bilateral basis.⁵¹ If market demand fluctuates, other competitors cannot identify whether a competitor lowers its price because it expects the coordinated price to fall or because it is deviating. Stable demand conditions, no growth/mature market and no demand shocks allow firms more easily to predict the reasons for other firms' actions.

2.2.3 *Deterrent Mechanism*

In early cases the Commission embraced an ambiguous attitude toward punishment mechanisms. In the assessment of *Airtours/First Choice* credit retaliation was not included in consideration. In its decision the Commission said:

The Commission does not consider that it is necessary to show that the market participants as a result of the proposed merger would behave as if there were a cartel, with a tacit rather than explicit cartel agreement [...]. In particular it is not necessary to show that there would be a strict

⁴⁹ Paragraphs 49-51, Guidelines on Horizontal Mergers. Citing Case COMP/M.2389 *Shell/DEA*, [2003] O.J. L15/35, points 112; and Case COMP/M.2533 *BP/E.ON*, [2002] O.J. L276/31, points 102.

⁵⁰ Paragraph 50, Guidelines on Horizontal Mergers. In *Sony/BMG* the Commission found the different majors' various 'campaign discounts' prevented the parallel price from being monitored. The opacity of discount was evidence for clearing the transaction finally. See Case COMP/M.3333 *Sony/BMG*, [2005] O.J. L62/30.

⁵¹ Note 67, Guidelines on Horizontal Mergers.

punishment mechanism. What matters for collective dominance in the present case is whether the degree of interdependence between the oligopolists is such that it is rational for the oligopolists to restrict output, and in this sense reduce competition in such a way that a collective dominant position is created.⁵²

A question arose with regard to the decision, namely how a mechanism of collusion can be sustained if firms can benefit from deviation, and do not need to bear any loss.⁵³ The decision proved controversial and was later successfully appealed by *Airtours*.⁵⁴ A timely retaliation mechanism has become a necessary condition of establishing coordinated effect. The General Court shows that demonstrating coordinated effect of a merger does not require evidence of actual punishment of deviators in the past. Rather, establishing the existence of a potential mechanism for deterrence is enough.⁵⁵ In general the more rapid the detection and punishment, the greater the incentives of firms to adhere to tacit coordination. Conversely, if detection and punishment are slow, there are greater opportunities to cheat.⁵⁶ The second consideration is the incentive for coordinating firms to retaliate. 'A critical condition for coordinated behaviour to be sustainable is that the benefits of deviation for each firm in the coordinating group must be outweighed by the expected costs resulting from the breakdown of the tacit understanding not to compete vigorously against one another'.⁵⁷ Thus a weaker punishment mechanism may be sufficient if the gains from cheating are limited. The third point which should be noted is that retaliation need not take place in the

⁵²Case IV/M.1524 *Airtours/First Choice*, [2000] O.J. L 93/1, paragraph 150.

⁵³See COIsson, *Collective Dominance - Merger Control on Oligopolistic Markets*, *supra* note 10, 21.

⁵⁴Paragraph 54, *Guidelines on Horizontal Mergers*. Excess capacity is a precondition of retaliation against any cheater. Case paragraph 261, Case COMP/M.1741 *MCI WorldCom/Sprint* [2003] O.J.L300/1.

⁵⁵ See case T-464/04 *Impala v Commission*, [2006] E.C.R. II-2289, paragraphs 463-474. For analysis of this case see G Aigner *et al.*, *The Analysis of Coordinated Effects in EU Merger Control: Where do We Stand after Sony/BMG and Impala*, (2006) Volume 2 No. 2, *E.C.J.*, pp.311-336.

⁵⁶ See paragraph 52, the *Guidelines on Horizontal Mergers*. Numerous game-theoretic models that explore different scenarios of coordination, cheating and enforcement exist in the economics literature. See E Green and R Porter, *Non-cooperative Collusion under Imperfect Price Information*, (1984) Volume 52 No.1, *Econometrica*, pp. 87-100.

⁵⁷S Bishop and A Lofaro, *A legal and economic consensus? The theory and practice of coordinated effects in EC merger control*, *supra* note 4, 200.

same market as the deviation, e.g. cancellation of joint ventures or other forms of cooperation or selling of shares in jointly owned companies.⁵⁸

2.2.4 Reaction of Outsiders

Even if the internal factors suggest that the firms in the coordinated group are able to reach and sustain a coordinated agreement not to compete aggressively, collective dominance may still not be possible. Nor should supporters of a collective dominance agreement have any market power to increase price above their current level if there is sufficient constraint from competitors outside the coordinating group in the market. Competitive constraints to coordination have no significant differences from competitors' constraints to single firm dominance in the market. They include ease of entry, the ability of fringe competitors to react to a post-merger price increase by oligopolistic companies, the extent of supply-side substitutability and the ability of large buyers to counteract the market power of the coordinating group.⁵⁹ These countervailing factors will be further examined in Chapter 5.⁶⁰

2.3 Causal Link between the Merger and the Coordinated Effects⁶¹

In order to assess how the merger changes the market competition dynamically the Commission states that a causal link should exist if as a result of the merger: a) it is significantly more likely that firms which did not previously coordinate their behaviour would begin to do so; or b) coordination would be easier, more stable or

⁵⁸ Paragraph 55, Guidelines on Horizontal Mergers.

⁵⁹ The relationship between unilateral effect and coordinated effect is discussed in S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, *supra* note 4, 207.

⁶⁰ Coordinated effect could be disrupted by the presence of a fringe of smaller firms or by the presence of a maverick competitor who does not share the collusive strategies of the large firms. Both factors have been considered by the Commission in analysing synergies. See *CVC/Danone/Gerresheimer*, [1999] O.J.C 214/7, paragraph 38; *France Telecom/Orange*, [2000] O.J.C 261/06, paragraph 28.

⁶¹ A discussion of the causal link can be found in A R Dick, Coordinated Interaction: Premerger Constraints and Post-merger Effects, (2003) Volume 12 Issues 1, *George Mason Law Review*, 65; K Kühn, Closing Pandora's Box? Joint Dominance after the "Airtours" Judgment, *supra* note 44, 18.

more effective for firms which were coordinating prior to the merger.⁶² First of all premerger competition is assessed as a reference point from which to compare with post-merger competition. For example, although a reduction in competitors will induce the remaining competitors to reach terms of coordination, too many competitors premerger may countervail the concern.⁶³ However, as the market situation is changing, the Court's judgment in *France v Commission* makes it clear that reliance on evidence of past behaviour should be limited.⁶⁴ The second step is to see the change brought about by merger on market competition, namely why the industry did not coordinate premerger but would post-merger, or why coordination premerger might occur again in future.⁶⁵ Such point 'tipping' from competition to coordination is frequently missing from the European Commission's assessment of coordinated effects.⁶⁶ In this respect the contribution of economic theory is also limited.⁶⁷

⁶² Paragraphs 22(b) and 39, Guidelines on Horizontal Mergers.

⁶³ One issue is whether that collusion or parallel conduct was likely before the merger and can constitute an argument for blocking a merger. In the 2002 draft Commission Notice on Horizontal Mergers the Commission states that 'It is unlikely that the Commission would approve a merger if coordination were already taking place prior to the transaction unless it determines that the merger is likely to disrupt such coordination'. This is a controversial article which extends the discretion of the Commission to correct pre-existing positions of market strength through merger control, and omitted from the final version of the Notice, and it is not adopted by the formal EUMR in the 2004. According to causal link theory only when merger further facilitates collusion is anti-competitive concern raised. Collusion premerger will not prevent the approval of mergers directly in merger review.

⁶⁴ Joined Cases C 68/94 and 30/95 *France v. European Commission* [1998] E.C.R. I-1375, Paragraph 163,

⁶⁵ Changes of merger to market competition include merger's affecting the degree of asymmetry of market shares of the various firms; or removal of a maverick firm; or enhancement of the partitioning of the market; or increase in the risk of tacit collusion by increasing suppliers' retaliation possibilities. See J Baker, *Mavericks, Mergers and Exclusion: Proving Coordinated Effects under the Antitrust Laws*, (2002) Volume 77 Issue 1, *New York University Law Review*, pp. 135-203; K Kühn, *Closing Pandora's Box? Joint Dominance after the "Airtours" Judgment*, *supra* note 44, 8; section IV.2 in F Polverino, *Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis*, *supra* note 15, pp. 11-16.

⁶⁶ S Bishop and A Lofaro, *A legal and economic consensus? The theory and practice of coordinated effects in EC merger control*, *supra* note 4, 212.

⁶⁷ It could be argued that economic theory has focused more on the mechanism by which coordination is sustained rather than the mechanism through which coordination is reached in the first place. In economic theory a merger can make coordination more likely by reducing the number of competitors, removing a 'maverick' firm or narrowing asymmetry. See S Bishop and A Lofaro, *ibid*, 217; H Haupt, *Collective dominance under Article 82 E.C. and E.C. merger control in the light of the Airtours judgment*, *supra* note 2, 435.

2.4 The Standard of Proof⁶⁸

2.4.1 Reason for Proposing a Standard of Proof

a. Factors have No Clear Hierarchy

As the market characteristics for tacit collusion are numerous one possible issue is whether it is necessary and possible to put the factors in order. Such sorting makes the process of assessing a merger more transparent if published. It also saves the antitrust authority time since the coordination effect does not need to be considered if the most relevant factors are absent.⁶⁹ The Commission does not publish the flowchart it uses in assessing different factors.⁷⁰ The difficulty, if not impossibility, of ranking factors is generally recognised and agreed.⁷¹ However, in a final report some suggestions are still given.⁷² It is found that a high market concentration and barriers to entry are prerequisites to a tacit collusion mechanism's feasibility; product homogeneity, market transparency and a mature

⁶⁸ P Szilagyi, *The CJEU has spoken: where do we stand with the Commission's Cases*, (2008) Volume 29 Issue 12, *E.C.L.R.*, pp. 726-728; B V Rompuy, *Implications for the standard of proof in EC merger proceedings: Bertelsmann and Sony Corporation of America v. Impala*, (2008) Volume 29 Issue 10, *E.C.L.R.*, pp. 608-612; P Eberl, *Following a close investigation the Commission approved the creation of the Sony/BMG music recording joint venture on 19 July 2004*, (2004) Number 3, *Competition Policy Newsletter*, pp. 7-10; B Vesterdorf, *Standard of proof in merger cases: reflections in the light of recent case law of the community courts*, (2005) Volume 1, Number 1, *E.C.J.*, pp. 3-33; J T Lang, *Two important Merger Regulation judgments: the implications of Schneider-Legrand and Tetra Laval-Side*, (2003) *European Law Review*, 268; D Bailey, *Standard of Proof in EC Merger Proceedings: A Common Law Perspective*, (2003) Volume 40 Issue 3, *Common Market Law Review*, pp. 847-888; F E G Diaz, *The Reform of European Merger Control: Quid Novi Sub Sole?*, [2004] Volume 27 Issue, *World Competition*, pp. 177-199; M Monti, *Merger control in the European Union: a radical reform*, (7th November 2002), speech given at the European Commission/IBA Conference on EU Merger Control, Brussels; S Baxter and F Dethmers, *Collective Dominance Under EC Merger Control – After Airtours and the Introduction of Unilateral Effects. Is There Still a Future for Collective Dominance?*, *supra* note 44, pp. 151-152; N Levy, *Mario Monti's Legacy in EC Merger Control*, [2005] Volume 1 No.1, *Competition Policy International*, pp. 123-125.

⁶⁹ European Economics, *Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control*, *supra* note 2, 42.

⁷⁰ Point 62 in B Alonson, *European Study Conference, Oligopolistic Dominance, Is there a Common Approach in Different Jurisdictions? A Review of Decisions Adopted by the Commission under the Merger Regulation*, Brussels 18/11/1995, available at: http://ec.europa.eu/competition/speeches/text/sp1995_036_en.html (accessed on the 23rd September 2013).

⁷¹ See '2.7.2 Ranking of criteria - Is it possible and reasonable to attach a relative importance to the criteria?' in European Economics, *Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control*, *supra* note 2.

⁷² *Ibid.*

market are very important factors which can result in a high probability of collusion.⁷³ If the above factors are fulfilled, the antitrust authority needs only to check if there is any countervailing effect like buyer power or maverick firm. If products are heterogeneous and the market is not transparent, the antitrust authority should ask if there is another form of coordination than price. The most complicated condition is that some but not all necessary conditions for coordinated effects are fulfilled in a merger case. The antitrust authority can only go back to the checklist approach and balancing the pros and cons factors carefully.⁷⁴ From a practical standpoint the Commission is advised to place greater weight on factors which have a clearer influence on the likelihood of collusion, such as market structure, rather than some behavioural indications, like multi-market contacts.⁷⁵

2. Factors have an Ambiguous Effect

Some market characteristics such as excess capacity and cross-shareholding can have both positive and negative effects on coordination.⁷⁶ Explaining the same factor from a different angle may lead to a different outcome. Therefore a conclusion of coordination can be easily criticised or even overturned by the Court. In order to ensure transparency and certainty the Court proposes the evidential threshold that the Commission must satisfy before it can prohibit a transaction.⁷⁷

⁷³There is still a view that the homogeneity of the suppliers cannot be accounted a strict requirement, unless the heterogeneity is likely to lead to different interests and strategies among remaining firms. See B Alonson, *Is there a Common Approach in Different Jurisdictions? A Review of Decisions Adopted by the Commission under the Merger Regulation*, *supra* note 70.

⁷⁴*Ibid*, 42. Section 3 in OECD, *Oligopoly*, *supra* note 28, 266.

⁷⁵European Economics, *Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control*, *supra* note 2, 85.

⁷⁶Take overcapacity for instance: coordinating firms should have certain overcapacity for them to increase output as retaliation against deviators from coordination. However, overcapacity may also reduce competitors' incentives to collude, as they have incentive and ability to expand production and escape collusion. The double-sided effects of cross share-holding are explained in point 5, 2.1.1 General Checklists.

⁷⁷ See A Lindsay, *The EC Merger Regulation: Substantive issues*, Second Edition, (Sweet and Maxwell, 2006), 63.

2.4.2 Reviewing the Establishment of the Standard of Proof

In 2002 the EU General Court annulled three consecutive merger decisions, which raised an interesting debate among practitioners and academics as to the standard of proof that the Commission must meet in order to prohibit concentrations under the EU Merger Regulation.⁷⁸ Through judicial review of *Sony/BMG*, the Courts finally set the standard of proof for the Commission.⁷⁹

Firstly, the Commission should have the symmetric assessment on likely or unlikely coordinated effects. In *Impala v Commission* the Commission declared it must ‘either prove to the required standard that post-merger coordinated effects occur or it must prove to the same standard that post-merger coordinated effects do not occur’.⁸⁰ Under the requirement of the symmetric assessment there might be a ‘grey area’ where neither merger-specific anticompetitive effects nor their absence can be proved sufficiently.⁸¹ Case decisions in ‘grey areas’ not only damage predictability but also give parties more space to overturn the decision in appeal proceedings.⁸²

Secondly, the Commission should distinguish between the *ex post* analysis of past coordination and the forward-looking assessment of the possibility of post-merger

⁷⁸The reasoning was claimed to have ‘manifest errors’. See *supra* note 47.

⁷⁹ See Case No COMP/M.3333 *Sony/BMG* [2005] O.J. L62/30. The Appeal on this decision is Case T-464/04 *Impala v Commission*, [2006] E.C.R. II-2289. In the US the FTC had also unconditionally approved the transaction. See FTC Press Release: FTC Closes Investigation of Joint Venture Between Bertelsmann AG and Sony Corporation of America, (July 28, 2004), available at <http://www.ftc.gov/opa/2004/07/sonybmj.htm> (accessed on the 25th October 2012).

⁸⁰ Case T-464/04 *Impala v Commission*, [2006] E.C.R. II-2289, paragraph 290; see also M F Bay and J R Calzado, *Tetra Laval II: the Coming of Age of the Judicial Review of Merger Decisions*, (2005) Volume 28 Issue 4, *World Competition*, pp. 433-453.

⁸¹ See K Wright, *Perfect symmetry? Impala v Commission and standard of proof in mergers*, (2007) Volume 32 Issue 3, *European Law Review*, pp. 408-418.

⁸² If so, in the EU a problem remains: there should be an optimal balance between the effective judicial protection of the rights of all the parties affected by merger and the merging parties’ need for legal certainty. This problem will not be further discussed in the thesis as there is currently no effective judicial review of merger decision in China. Discussion of this issue can be found in R Brandeburger and T Janssens, *European Merger Control: Do the Checks and Balances Need to Be Re-set?*, [2001] *Fordham Corp Law Institute*, 177; L Prete and A Nucara, *Standard of Proof and Scope of Judicial Review in EC Merger Cases: Everything Clear after Tetra Laval?*, *E.C. L.R.*, Volume 26 Issue 12, 2005, pp. 692-704; A Christiansen and W Kerber, *Competition Policy with Optimally Differentiated Rules Instead of ‘Per se Rules vs. Rule of Reason’*, (2006) Volume 2 Issue 2, *Journal of Competition Law and Economics*, pp 215-244.

coordinated behaviour.⁸³ The historical evidence concerning the assessment of coordinated effects includes the coordination record before,⁸⁴ cartel record before and the movement evidence of effective competition.⁸⁵ The issue is how appropriate it is to compare the market over time or across geographical areas. In *Sony/BMG* the Commission paid great attention to proving that there was no collective dominant position before the concentration.⁸⁶ Nevertheless, the General Court demanded a much more detailed analysis of the probable effects of the change in market and firm characteristics caused by the merger.⁸⁷ Finally, the clearance decision of the Commission was annulled by the General Court because of ‘manifest errors of assessment’. To use evidence of past coordination the Commission should state clearly that the relevant market characteristics have not changed appreciably or are not likely to do so in the near future.⁸⁸ However, past coordination may be either express or tacit, depending on different market situations.⁸⁹ One weakness of the EU is that it fails to illustrate the distinct treatment to the two kinds of past coordination.

⁸³ G Robert and C Hudson, Past co-ordination and the Commission Notice on the appraisal of horizontal mergers, *supra* note 7, 167.

⁸⁴ See Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraphs 168-172; Case No IV/M.308 *Kali+Salz/Mdk/Treuhand*, [1994] O.J. L186/38, paragraph 57.

⁸⁵ In *AKZO Nobel* the Commission established that in some of the affected markets the fluctuation in market shares was evidence of competition, and concerns at coordinated behaviour were unwarranted. Case COMP/M.1681 *AKZO Nobel/Hoechst Roussel Vet*, [2000] O.J. C11/07.

⁸⁶ Case COMP/M.3333, *Sony/BMG* [2005] O.J. L62/30.

⁸⁷ In respect of forward orientated analysis the Commission’s examination was considered ‘extremely succinct’ and was so superficial that it could not satisfy the Commission’s obligation to carry out a prospective analysis. See Case T-464/04 *Impala v Commission*, 2006, E.C.R. II-2289, paragraph 525. Appeal case before the ECJ was C-413/06 P, *Bertelsmann AG v. Impala*, 2008, E.C.R. I-04951.

⁸⁸ Paragraph 43, Guidelines on Horizontal Mergers. Evidence of coordinated effects premerger includes similarities in price movements, evidence of suppliers’ ability to increase prices, of retaliation and so on. For an approach to collecting evidence see S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, *supra* note 4, pp. 195-242; International Competition Network, *Investigative Techniques Handbook for Merger Review*, (June 2005), available at: <http://www.internationalcompetitionnetwork.org/uploads/library/doc322.pdf> (accessed on the 9th June 2012).

⁸⁹ For past cartel scholars refer to the finding of the US authorities that the cartels are more prone to happen in markets with low concentration which is in contrast to the operation of tacit coordination. Therefore notifying parties are recommended to use the ways of operating cartel to prove the impossibility of tacit collusion post-merger. See G Robert and C Hudson, Past co-ordination and the Commission Notice on the appraisal of horizontal mergers, *supra* note 7, 168.

In order to meet the standard of proof, merger assessment is moving towards to a more economic approach.⁹⁰ A detailed economic analysis was undertaken by the Commission in *Sony/BMG*, which can rightfully be called one of the largest and most complex econometric analyses conducted thus far in the context of EU merger control.⁹¹ The new EU Merger Regulation in 2004 clearly recognised the need for a sound economic framework. The Commission appointed a chief economist and an accompanying team of economists to advance the use of economics in the Commission's decision-making.⁹² However, the standard of 'cogent evidence' is hard to reach at the current stage.⁹³ Scholars conclude that there are no market share thresholds that can be applied and there is no presumption of competitive harm, even if a merger reduces the number of players from three to two.⁹⁴ Indeed, unlike unilateral effects, no economic theory can predict that a horizontal merger would tend to result in a price increase based on coordinated effects. Likewise, economists have not (yet) been able to develop refined econometric techniques for the assessment of collective dominance cases.⁹⁵ Although *Sony/BMG* indicates the increased importance of economic analysis, it raises the question of whether the requirement of a quantitative test will undermine the efficiency of the

⁹⁰ For discussion of a more economic approach to EU merger control see: A Christiansen, *The Reform of EU Merger Control - Fundamental Reversal or Mere Refinement?*, (2006), available at SSRN: <http://ssrn.com/abstract=898845>; A Christiansen, *The 'More Economic Approach' in EU Merger Control*, CESifo Forum, 7 (1), Spring 2006, pp.4-39, available at: <http://www.cesifo-group.de/link/forum1-06-focus6.pdf> (the above two articles were accessed on the 25th October 2012). See also Y Botteman, *Mergers, Standard of Proof and Expert Economic Evidence*, *Journal of Competition Law and Economics*, (2006) Volume 2 Issue 1, pp.71-100.

⁹¹ See *Mergers: Commission confirms approval of recorded music joint venture between Sony and Bertelsmann after re-assessment subsequent to Court decision*, (3rd October 2007), Commission Press Release *IP/07/1437*.

⁹² See A Christiansen, *The Reform of EU Merger Control - Fundamental Reversal or Mere Refinement?*, *supra* note 90, pp.123-125.

⁹³ For example, the General Court criticised one of the Commission's points as not being supported by a 'sufficiently cogent and consistent body of evidence'. See *Case C-68/94 France v Commission of the European Communities* [1998] E.C.R. I-1375. However, the criterion of 'cogent evidence' has not been explained by the court to date.

⁹⁴ See Point 1 in '2.1.2 An Evaluation of the Checklist Approach'.

⁹⁵ For discussion of the economic techniques of coordinating assessment see P Sabbatini, *How to simulate the coordinated effect of a merger*, (2006) Volume 12, *Autorità Garante della Concorrenza e del Mercato, Temi e Problemi*, Available at: <http://www.agcm.it/temieproblemi.htm> (accessed on the 23rd September 2013); W JKolasky, *Coordinated Effects in Merger Review: From Dead Frenchmen to Beautiful Minds and Mavericks*, Antitrust Division, U.S. Department of Justice, (April 2002), available at: http://www.globalcompetitionforum.org/regions/n_america/USA/11050.pdf (accessed on the 23rd September 2013).

Commission's merger control and increase legal uncertainty.⁹⁶ Because coordinated effect is hard to predict and prove, the Commission's ability and incentive to apply collective dominance in merger cases has been much reduced in the past few years, resulting in fewer cases in which such a theory was seriously or successfully pursued.⁹⁷ Some find that the standard of proof in the EU makes 'the Commission's decisions more economically sound'.⁹⁸ However, another view regards the symmetric assessment as too conservative and likely to result in the undue clearance of mergers which eventually prove harmful to competition.⁹⁹

To sum up, in order to reflect the coordinated effect of a merger on market competition, a number of improvements have been adopted. These are made through 'gradual refinement on the conceptual level coupled with an increasing standard for finding of coordinated effects in a particular case and economic approach'.¹⁰⁰ The first improvement was a transition from the checklist approach to use of an analytical framework to assess coordinated effects. This avoids the uncertainty that the number of market characteristics favouring coordination outweigh those against, while coordinated effects still do not appear; The second improvement was to add the dynamic analysis of causal link between merger and coordinated effect. This prevents the error of the Commission's only focusing on the static market situation before or after merger. A false negative error would result if the Commission's decision depends on the pre-merger situation, while

⁹⁶ For brief analyses of this case see F Dethmers, *Collective Dominance under EC Merger Control – After Airtours and the Introduction of Unilateral Effects is there still a Future for Collective Dominance?*, *supra* note 44, pp.638-649; F Polverino, *Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis*, *supra* note 15. PEerl, following an in-depth Investigation the Commission approved the Creation of the Sony/BMG Music Recording Joint Venture, 19 July 2004, No. 3, *Competition Policy Newsletter*, pp.7-10; V R Ben and P Caroline, *Is the standard of proof imposed by the Community Courts undermining the efficiency of EC merger control? The SONY/BMG joint venture case in perspective*, (May, 2007), *EUSA Tenth Biennial International Conference*, available at: <http://aei.pitt.edu/8013/1/rompuy-b-02g.pdf> (accessed on the 25th October 2012).

⁹⁷ AWeitbrecht, *EU Merger Control in 2005—An Overview*, (2006) Volume 27 Issue 2, *E.C.L.R.*, pp 43-50.

⁹⁸ E V Liberis, *Impala V. Commission: Changing the Tune of European Competition Law*, (2008) Volume 83 Issue 3, *Chicago-Kent Law Review*, 1521

⁹⁹ F Polverino, *Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis*, *supra* note 15, 1.

¹⁰⁰ See G Aigner *et al.*, *The Analysis of Coordinated Effects in EU Merger Control: Where Do We Stand after Sony/BMG and Impala?*, *supra* note 55, pp. 3-9. See III.3 in F Polverino, *Assessment of Coordinated Effects in Merger Control: between Presumption and Analysis*, *supra* note 15, pp.36-38.

coordination is less likely post-merger. A false positive error would result if the Commission makes a decision depending on market characteristics post-merger which have existed in the market prior to the merger. The merger does not significantly change the market situation. The third improvement was increasing the standard of proof to the ‘most-likely’ and ‘symmetric’ level.¹⁰¹ This reduces the chance of the merger decision’s being overturned by the Court.

Nevertheless, certain weaknesses in merger assessment still exist. Some weaknesses seem unavoidable within the current economic theory, such as that no theory provides guidance as to the situation in which coordination would definitely happen in future. The Commission still has the discretion to make case decisions depending on unpredicted market factors and economic theory. Merging parties have no possibility to disprove the Commission’s claims. Secondly, the point of transition from competition to coordination still cannot be proved by any qualitative or quantitative test. The Commission has space to predict when this transition could happen. Thirdly, a high standard of proof leaves a ‘grey area’ in which evidence is not sufficient to prove a decision of clearance or prohibition. In such situations the outcome is unpredictable.

3 Assessment of Coordinated Effects in China’s Merger Control

This section will briefly examine the assessment of coordinated effects under China’s merger control regime. The purpose is to see whether coordinated effects are evaluated properly, and whether the reasoning process of merger review is made transparent to the public.

¹⁰¹ According to the ‘symmetric’ requirement, if the coordinated effects will be created post merger, the MOFCOM should prove the probability is more than 51% ,although the precise percentage is impossible to estimate as there is uncertainty about future facts and the rigorous time-limit; on the other hand, if the coordinated effect will be strengthened post-merger, the MOFCOM should prove the existence of coordination prior to the merger.

3.1 Checklist Period in China

According to the Interim Rules, when there are only a few business operators in the relevant market to which the concentration belongs the MOFCOM should investigate whether transactions will create or increase the ability, incentive and likelihood of business operators to eliminate or restrict competition in cooperation.¹⁰² However, the MOFCOM does not clarify how to analyse the ‘ability’, ‘incentive’ and ‘likelihood’ in investigation. The assessment of coordinated effect in China is analysed in line with the checklists approach in the EU.

First of all the MOFCOM realises that fewer competitors may lead firms to reach a common understanding on the terms of coordination. However, the MOFCOM does not clarify the upper-bound of remaining competitors which is likely to reach terms of coordination post-merger. Before *Seagate/Samsung*, the MOFCOM raised coordinated effects in a duopoly post-merger.¹⁰³ This is similar to the circumstances of the EU before 1997. In *Seagate/Samsung* four remaining competitors post-merger was also considered to reach terms of coordination.¹⁰⁴ Secondly, the MOFCOM also recognises that parallel behaviour is more likely to take place among competitors producing homogeneous products who can easily acquire knowledge of each other’s technical skills, costs, output and sale conditions.¹⁰⁵ Thirdly, structural links between remaining firms are also considered by the MOFCOM in reaching terms of coordination post-merger. Examples of structural links include sales and distribution agreements between merging parties and their rivals.¹⁰⁶ The MOFCOM

¹⁰² Paragraph 2, Article 4, Ministry of Commerce of the People's Republic of China, Announcement No. 55 of 29th August 2011, Interim Rules on Evaluating Competitive Effects of Concentration of Business Operators (hereinafter ‘Interim Rules’), available in appendix.

¹⁰³ In *Novartis/Alcon* the MOFCOM was anxious about the coordinated effect between a subsidiary company of the merged entity and Haichang Company post-merger. In *Uralkali/Silvinit* concern was raised at the coordinated effect on the merged entity and the world’s largest potassium chloride supplier; in *Savio/Penelope*, such concern was at collusion between a subsidiary company of merged entity and Ulster Company. Case Announcement MOFCOM [2010] No.53 *Novartis / Alcon*; Announcement MOFCOM [2011] No.33 *Uralkali / Silvinit*; Announcement MOFCOM [2011] No.73 *Savio / Penelope*.

¹⁰⁴ Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹⁰⁵ Section 2-2)-point 2, Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹⁰⁶ *Novartis/Alcon* decision is the first case in which MOFCOM has imposed conditions to address ‘coordinated effects’ in the market of contact lens care products. As shown by investigation, Shanghai

does not consider structural links to be a necessary condition of coordinated behaviour.¹⁰⁷ This is also current practice in the EU.¹⁰⁸

The above three factors are all market characteristics that the MOFCOM has assessed in considering coordinated effect. Compared with its EU counterpart, this checklist is incomplete. There are a number of factors which the MOFCOM does not consider, like the demand and supply conditions of coordinating firms, the extent of symmetry between coordinating firms, and the influence of innovation on coordination. Neglect of these factors might make the decision of coordination unreliable. In *Seagate/Samsung* the MOFCOM did not consider the heterogeneity of leading firms' products, asymmetrical market shares among major competitors and the countervailing effect of innovation. This resulted in the MOFCOM's overestimating the acquired firm's-Samsung role in market competition, and imposing sharp commitments on clearance.¹⁰⁹ Conversely, the European Commission found that 'it is apparent that it is unlikely that the proposed transaction will

Shikang Trading Co., Ltd (Shanghai Shikang), a wholly owned subsidiary of Novartis, signed a Sales and Distribution Agreement with Haichang in 2008, which made Haichang the sole distributor of Shanghai Shikang in the territory of China. Shanghai Shikang and Haichang have set up a strategic affiliated partnership. The regulator might have been concerned that the link between the new Novartis/Alcon entity and Haichang (through the distribution agreement) would align their behavior in the marketplace. Therefore, within 12 months of the effective date of the MOFCOM review decision, Novartis was required to terminate the Sales and Distribution Agreement between Shanghai Shikang and Haichang. Section six-2), Announcement MOFCOM [2010] No.53 *Novartis/Alcon*.

¹⁰⁷ There are no structural links between or among coordinating firms in the case *Savio/Penelope* or *Seagate/Samsung*. Announcement MOFCOM [2011] No.73 *Savio/Penelope*; Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹⁰⁸ See *supra* point 5 in '2.1.1 General Checklists'. See also Case IV/M.619 *Gencor/Lonrho*, [1997] O.J. L11/30, paragraphs 104-105.

¹⁰⁹ The MOFCOM asserted that a merger would lead to the loss of an important competitor (Samsung). It evaluated the important role of Samsung in the hard disk market on two criteria, ability to sustain the purchase model and maintain innovation. The MOFCOM found that large computer manufacturers generally adopt a confidential bidding process to conduct seasonal bilateral negotiations with HDD manufacturers. Investigation reveals that, to ensure security of supply, computer manufacturers will purchase from two to four HDD manufacturers in light of factors such as price (the most competitive bidder receiving the largest order, the second a smaller order, and the others maybe not receiving any order). Although four main competitors after merger are enough to sustain the purchase model, the MOFCOM was still concerned that the loss of Samsung would increase the possibilities of the rest of competitors' getting orders at the same time. Therefore the pressure of competition coming from the purchase model will be reduced. Given the lower pressure of competition the MOFCOM further emphasised that competitors would have less motive to conduct innovation. In addition, as the HDD market is transparent, the MOFCOM speculated that HDD producers had the ability to supervise each other's actions. Therefore the transaction would increase the likelihood of tacit collusion among competitors post-merger. Eventually, because of both coordinated effect and unilateral effect, the merger was cleared with significant remedies. Paragraph 3, point 2, section 2, Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

increase the ability of the remaining HDD suppliers to reach terms of coordination', which is directly at odds with the MOFCOM's conclusion above.¹¹⁰ The Commission indicated that a reduction to four HDD manufacturers post-merger would not necessarily imply a merger-specific risk of coordination in those markets.¹¹¹ The factors include the following: 1. The Commission did not find evidence of successful coordination in the relevant markets such as 3.5" Desktop, in which only four HDD suppliers are currently competing with each other;¹¹² 2. Samsung, as the acquired party, was neither a particularly strong innovative force nor a particularly strong competitor. Therefore Samsung is unlikely uniquely to have constrained suppliers' ability to coordinate or sustain coordination premerger in these markets. The effect of Samsung's removal is therefore likely to be limited with regard to coordinated effects;¹¹³ 3. Due to the asymmetry of market share both pre and postmerger, there would be a lack of incentive for HGST to participate in any coordination.¹¹⁴ The internal documents of HGST also showed that it had the incentive to expand sales and increase its share from [10-20]*% in 3.5" Desktop HDD after the proposed transaction. Finally, the same transaction was cleared outright in the EU.

In conclusion, checklists for analysing coordination effect in China are incomplete. A number of necessary factors have not been considered in published case decisions. No rules further clarify whether those neglected factors should be taken into consideration. This leaves the public uncertain about the outcome of coordination effect, as they remain unsure what kind of factors will be considered by the MOFCOM in the final decision. Market transparency for monitoring

¹¹⁰ Case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3, paragraph 554,

¹¹¹ The Commission did not find evidence of successful coordination in relevant markets such as 3.5" Desktop, in which only four HDD suppliers are currently competing .

¹¹² Previous evidence in a market might give useful insights into the likely future behaviour of the oligopoly as well as into the motives for the merger. This is true in markets where there have been structural links or which have a long-standing history of cartel behaviour. However, such elements are of course not sufficient to block a merger. See OECD, *Oligopoly*, *supra* note 28, 220.

¹¹³ Case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3, paragraph 550,

¹¹⁴ The Commission finds that in the 3.5" Desktop HDD market, the combined entity has [50-60]*% of sales, WD [30-40]*%, and HGST accounting for [10-20]*% of sales. Therefore there would be a clear lack of incentive for HGST to participate in any coordination. See case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3, paragraph 551.

deviations is not a necessary step to creating or strengthening coordinated effect in China. By October 2012 the MOFCOM has only considered the transparency of product market which facilitates monitoring deviations in two cases, namely *Seagate/Samsung* and *Western Digital/Hitachi*.¹¹⁵ The MOFCOM states that transaction increases the probability of HDDs manufacturers' coordinating their behaviour. Because of the relative transparency of the HDD market HDD manufacturers can predict the behaviour of their rivals.¹¹⁶

Nor does the MOFCOM consider sufficient retaliation to be a necessary condition of keeping coordinating firms from deviating. Thus before July 2013 no published decision mentions whether past deviators have been punished or whether there is a possible mechanism for deterrence among coordinating firms.

The third issue of assessment of coordinated effects is the reaction of outsiders. The MOFCOM is only concerned with the effects of entry on expected coordination. For instance, in *Uralkali/Silvini* the MOFCOM considered entry barriers, in particular the time and capital required to enter into or expand operations. The MOFCOM concluded that the entry barriers in the relevant market were relatively high.¹¹⁷ Apart from potential entry, the actions of non-coordinating firms as well as countervailing buyer power of customers are all able to jeopardise the outcome expected from coordination.¹¹⁸

¹¹⁵ Announcement MOFCOM [2011] No.90 *Seagate/Samsung*; Announcement MOFCOM [2012] No.09 *Western Digital Ireland/Viviti Technologies*.

¹¹⁶ The MOFCOM found that the number of hard disk (HDD) manufacturers and major buyers was few and HDD products were homogeneous. Information on the technology, cost, production and sales of HDDs were transparent to rivals. Given this information manufacturers were able to predict each other's product price and price range. In addition, hard drive manufacturers could easily gain knowledge of other producers' product information through sharing distribution channels. Section 2-(2), point 3, Announcement MOFCOM [2011] No.90 *Seagate/Samsung*.

¹¹⁷ Announcement MOFCOM [2012] No.09 *Western Digital Ireland/Viviti Technologies*.

¹¹⁸ Countervailing factors will be discussed further in Chapter 5.

3.2 Causal Link between Merger and Coordinated Effects

The MOFCOM is ambiguous in its explanation of the causal link between a merger and its coordinated effects. It is common for final decisions not to explain how the collusive mechanism operates or why collusion is significantly more likely post-merger. For example, in *Uralkali/Silvinit*,¹¹⁹ the MOFCOM found that the merger would create the second-largest potassium chloride supplier in the world, with a market share exceeding one third of the global market. In particular the MOFCOM found that the merger would increase the merging parties' market power by creating a large leading supplier of potassium chloride. Furthermore, following the merger, the merged company and the market leader would constitute 70% of the global market, which would raise the prospect of coordination between major potassium chloride suppliers in China. Both unilateral and coordinated effects theories of harm underlay the decision. About the concern of coordinated effects the MOFCOM did not explain the premerger situation, nor why collusion was significantly more likely post-merger, or how the collusive mechanism would operate after merger, or how deviation from the tacit collusion might be monitored and punished.¹²⁰ While few antitrust analysts would question the correctness of the MOFCOM's exploring these concerns during its review process, the decision was mainly criticised for providing little evidence of intensive investigation of the issue.¹²¹ This decision suggests that the mere likelihood (or risk)

¹¹⁹ Announcement MOFCOM [2011] No.33 *Uralkali/Silvinit*.

¹²⁰ See Clifford Chance, Horizontal mergers in the China context: The Uralkali/Silvinit potash merger and continuity of supply obligations, (August 2011), available at: http://www.cliffordchance.com/publicationviews/publications/2011/08/horizontal_mergersinthechinacotextth.html (accessed on the 30th October 2012).

¹²¹ In order to exclude anti-competitive concerns the Commission requires the merged entity to continue the *status quo* regarding supply and price-setting mechanisms applicable to Chinese buyers. There is still criticism of these behavioral commitments. The MOFCOM is blamed for not predicting the future changes in the market. Maintaining the *status quo* is impossible and hard to monitor. See Freshfields Bruckhaus Deringer LLP, MOFCOM conditionally clears Uralkali's acquisition of Silvinit, (6th June 2011), available at: <http://www.lexology.com/library/detail.aspx?g=cda5cf6b-ce31-4d12-99c2-1751d88c0506> (accessed on the 31st October 2012); Clifford Chance, Horizontal mergers in the China context: The Uralkali/Silvinit potash merger and continuity of supply obligations, (August 2011), available at: http://www.cliffordchance.com/publicationviews/publications/2011/08/horizontal_mergersinthechinacotextth.html (accessed on the 31st October 2012); N.H. F. Chang, H Hai and G O'Brien, China: Antimonopoly Law, (2012), *The Asia-Pacific Antitrust Review 2012*, available at:

of coordination in an oligopolistic market may be enough to raise coordinated effects concerns. It also suggests that a market with few suppliers having very high market shares and high barriers to market entry may be enough to trigger concerns. A false negative error might result if the MOFCOM identified coordinated effects depending on high market shares of coordinating firms in the market exclusively. If the members of coordination have varied market shares, they are unwilling to reach the term of coordination. In addition, even if market concentration indicates that coordination is likely, the power of non-coordinating firms in the market might possibly countervail the price increase of the collusion.¹²² The mechanism of operation in tacit collusion and constraints from fringe competitors has again been neglected by the MOFCOM.

In *Savio/Penelope* the acquiring party, *Penelope*, was a special purpose vehicle set up specifically for this transaction.¹²³ *Penelope* was wholly owned by Alpha Private Equity Fund V (Alpha V), a private equity fund. It was also the largest shareholder, with 27.9% equity stake in Uster Technologies CO. Ltd. (Uster). The target of the acquisition was Savio. Loepfe Brother Ltd. (Loepfe), which was a wholly-owned subsidiary of Savio. During the investigation the MOFCOM found that Uster and Loepfe were the only two manufacturers of electronic yarn clearers for automatic winders in the world. After the concentration Uster and Loepfe were likely to coordinate their business activities through Alpha V to restrict or eliminate competition in the market for electronic yarn clearers for automatic winders. At the same time Alpha V was also likely to engage in activities restricting or

<http://www.globalcompetitionreview.com/reviews/42/sections/146/chapters/1643/china-antimonopoly-law/> (accessed on the 31st October 2012); Mayer Brown, China Imposes Conditions on Uralkali/Silvinit Merger after Anti-monopoly Review, (June 2011), available at: <http://www.mayerbrown.com/publications/China-Imposes-Conditions-on-UralkaliSilvinit-Merger-after-Anti-monopoly-Review-06-08-2011/> (accessed on the 31st October 2012).

¹²²In *Airtours/First Choice* the Commission found that the market structure was characterised by four large operators integrated with upstream and downstream enterprises, plus numerous small, largely non-integrated independent operators and agents. Therefore the Commission believed that even without the merger the fringe small firms were not able to constrain the four large ones effectively. This argument was resisted by the General Court. It stated that 'the small operators can increase capacity in order to take advantage of general under-supply brought about by the large tours operators'. In the meantime, 'market entry is likely to allow potential competitors to gain access into the market'. Therefore, even without middle-size enterprises, a number of small competitors and potential entry can also countervail price increase of coordinating firms. See case T-342/99 *Airtours v Commission* [2002] E. C. R II-02585, paragraphs 261 and 269.

¹²³The first case published by the MOFCOM where a private equity house is involved.

eliminating competition by way of its control and influence over Ulster and Leopfe. The difficulty with this question herewas how Alpha V controlled Ulster, which only held 27.9% of the shares in Ulster. The MOFCOM onlydescribes its scope of analysis in shareholding structure, voting mechanism and attendance records at shareholders' meetings, board composition and board voting mechanism. However, it is not clear whether control over a *de facto* majority of votes is required in the general assembly and/or board of directors, or what other level indicated 'control' or 'influence'. As a result market players did not have clear benchmarks for the assessment of their minority investments under the AML's merger control rules.¹²⁴In *Novartis/Alcon* the notice simply states that the agreement between No.1 and No.2 competitors in the market may lead them to coordination on pricing, sales volumes and sales regions. Competition in the market will be eliminated or restricted by the coordination. However, the issue is that the MOFCOM neither clarifies how exactly coordination works in practice, norindicates the likelihood and actual market impact of such coordination.¹²⁵

3.3 Requirement of the Standard of Proof

In *Savio/Penelope*, when identifying the likelihood of coordination between the merged entity and the third party, the MOFCOM ascertained that it could not rule out the possibility of Alpha V's participating in or influencing the operations of Uster.¹²⁶Therefore the merger transaction was considered to raise coordination concerns and Alpha V was asked to transfer its shares in Uster to an

¹²⁴Indeed, the antitrust laws of both the EU and the US, for example, acknowledge that minority investments in competitors can, in certain circumstances, have anti-competitive effects. However, in the US and the EU the availability of public decisions by courts and authorities give market players some specific guidance on the legal benchmarks for this type of investments. In China, by contrast, while the Alpha V/Saviodecisionrepeats the principle that minority shareholdings in competitors can be problematic, it does not provide any details of how exactly coordination between Ulster and Loepfe would work in practice. See AEmch et al., MOFCOM Imposes Divestiture Obligation in Its Approval of Private Equity Transaction, (November 2011), *Hogan Lovells News and Publications*, available at: <http://www.hoganlovells.com/mofcom-imposes-divestiture-obligation-in-its-approval-of-private-equity-transaction-11-07-2011/>(accessed on the 30th October 2012).

¹²⁵ Mayer Brown, Unusual Remedies a Feature of MOFCOM's 6th Conditional Clearance Decision, (August 2012), available at: <http://www.mayerbrown.com/files/Publication/967c3a04-6e4d-4fe6-87c6-070dba6dd979/Presentation/PublicationAttachment/d95d82d9-1a83-44bd-9572-1a2eff821564/Unusual-Mofcom.pdf> (accessed on the 30th October 2012).

¹²⁶ The relationship between Alpha V and merging parties can be seen in the case study in '3.2 Causal Link between the Merger and the Coordinated Effects' in this chapter.

independent third party within six months of the date of the MOFCOM's decision.¹²⁷ The conclusion that 'the possibility of control could not be excluded' indicates a very low threshold and effectively places the burden of proof on the merging parties.¹²⁸ In *Seagate/Samsung* the MOFCOM only stated that the transaction increased the likelihood of firms' eliminating or restricting competition corporately post-merger. However, it did not state whether there was coordination prior to the merger. In either condition the chance of coordination after transaction may not be greater than 50 percent or to 'most likely' level. This standard of proof is significantly lower than the requirement of the EU.

In the EU only if the Commission has evidence of coordination prior to the merger are the notifying parties responsible for proving that merger makes coordination less likely to happen post-merger.¹²⁹ However, in China, once a coordination concern is raised by the MOFCOM even without sufficient evidence, merging parties still need to prove that it is unlikely. The disparity raises a problem, namely that the burden of proof borne by the merging party is too heavy.

In conclusion, where the competition authority in the EU has shown some reluctance to invoke coordinated effects in recent years, the MOFCOM continues to demonstrate ample discretion when it comes to remedies.¹³⁰ Both the enforcement authorities in the EU and China have certain discretion in assessing coordinated effects. For example, collective dominance is not limited in the number of two enterprises after merger. Structural links between coordinating firms is not a necessary condition of finding tacit collusion. However, the MOFCOM enjoys more flexibility in assessing coordinated effect than the EU. There is no analytical framework in evaluating the anti-competitive coordinated effect; each decision is made according to different facts listed by the MOFCOM. The MOFCOM does not

¹²⁷ Section 4, point 1, Announcement MOFCOM [2011] No.73 *Savio / Penelope*.

¹²⁸ Linklaters, MOFCOM's Conditional Approval for Penelope's Acquisition of Savio, (November 2011), available at: <http://www.linklaters.com/Publications/AsiaNews/LinkstoChina/Pages/MOFCOM-Conditional-Approval-Penelopes-Acquisition-Savio.aspx> (accessed on the 30th October 2012).

¹²⁹ See '2.3 Causal Link between the Merger and the Coordinated Effects' in the chapter.

¹³⁰ This point is also raised in Linklaters, MOFCOM conditionally approves Novartis/Alcon, (20th August 2012), available at: http://www.linklaters.com/Publications/AsiaNews/HongKongCorporateUpdate/Pages/MOFCOM_Conditionally_Approves_Novartis_Alcon.aspx (accessed on the 30th October 2012).

take the deterrent mechanisms as a necessary condition of successful coordination. The standard of proof for coordinated effect is lower than the ‘most likely’ criterion in the EU. All of this discretion means the merging parties and the public are unsure about the results of notified transactions. In fact the MOFCOM may not be sure the coordination effect will occur after a merger. Therefore no transaction has been cleared with significant commitments or prohibited due to coordinated effect exclusively in China.¹³¹

4 Discussion and Recommendations

4.1 Establish Analytical Framework

The most significant concern with the ‘checklist approach’ currently may be that it does not provide a systematic framework within which to assess market characteristics.¹³² Pandora’s Box was opened for all kinds of speculative argument about the potential effects of a merger.¹³³ In order to improve the degree of certainty the checklist approach should be replaced by an analytical framework. Indeed, guidance on how the MOFCOM will analyse coordinated effects was already contained in the draft guidelines on horizontal mergers prepared by the MOFCOM for internal discussion towards the end of 2009. In the summer months of 2010 the MOFCOM held internal seminars with a few select academics on topics including coordinated effects.¹³⁴ Nevertheless, framework for assessment of coordinated effects has not yet been clarified by now. In general the assessment of coordination effect has three aspects: ‘internal factors’ refers to the ability of firms that are alleged to form part of the coordinating group to act as if they were a single entity; ‘external factors’ refers to constraints of coordination that are

¹³¹The MOFCOM raised the concerns of unilateral effects accompanied by coordinated effects in some cases. A H Zhang and M Hephcott, *Merger Control in China*, (2011) Volume 11 No.11, *Competition Law Insight*, 19.

¹³² See the discussion in ‘2.1.2 An Evaluation of the Checklist Approach’ in this chapter.

¹³³ The problem was raised in K Kühn, *Closing Pandora’s Box? Joint Dominance after the “Airtours” Judgment*, *supra* note 44, 19.

¹³⁴Hogan Lovells LLP, *MOFCOM’s Stance on Novartis/Alcon*, (September 2012), available at: <http://www.hoganlovells.com/files/Publication/c4e3f64b-a523-482b-a6e8-f884e9e21792/Presentation/PublicationAttachment/b2aacda4-321f-4756-846d-04f304d85490/JunWei.pdf> (accessed on the 30th October 2012).

external to the coordinating group; and ‘causal link’ refers to how the merger affects the ability of firms to reach and/or sustain a tacit understanding.¹³⁵

In the EU ‘internal factors’ for tacit coordination include whether coordinating firms are able to reach terms of coordination, monitor deviation and retaliate to deviation. The question is why some of the EU’s ‘internal factors’ have not appeared in China’s case decisions.¹³⁶ The first reason may be the comparatively short time of implementation. In 1992 the Commission applied the concept of collective dominance under the Merger Regulation for the first time,¹³⁷ three years after the EU merger regulation came into force. After that great changes happened in assessing coordination effect, such as expanding the scope of coordination from a duopoly to fewer than four members after merger;¹³⁸ loosening the necessary relationship between structural links and the likelihood of coordination effect; laying down the retaliation mechanism as a necessary condition for sustaining coordination; and setting a standard of proof for the Commission in order to prove anticompetitive coordinated effect.¹³⁹ In 2002 in *Airtours/First Choice* an analytical framework was proposed by the General Court within which to organise the competitive assessment into steps. Based on the decision the final framework for assessing coordinated effect was issued by the Commission in its Guidelines on Horizontal Mergers in 2004, which was 18 years after the entry into force of EU Merger Regulation. The AML 2008 in China has only been implemented for four years. It may still need more time and experience to change from the checklist to a settled framework. Secondly, it may be because of restricted communication between the MOFCOM and related parties. Parties and

¹³⁵ This opinion was raised by S Bishop and A Lofaro in S Bishop and A Lofaro, A legal and economic consensus? For the theory and practice of coordinated effects in EC merger control, *supra* note 4, pp. 195-242.

¹³⁶ See the discussion in ‘3.1 Checklist Period in China’ in the chapter.

¹³⁷ Case IV/M.190 *Nestlé/Perrier*, [1992] O. J. L 356/1.

¹³⁸ *Airtours/First Choice* was the first case in which the Commission prohibited a merger that would have left three major firms in the market. See European Economics, Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control, *supra* note 2, 73.

¹³⁹ In *Sony/BMG* the standard of proof for proving coordinated effect was still facing overwhelming criticism. See *supra* note 68.

third parties lack opportunities to make their voice heard by the MOFCOM in order to supplement the MOFCOM's insufficient investigation.¹⁴⁰

These three factors' contributions to the assessment of coordinated effect have been discussed above.¹⁴¹ The MOFCOM should confirm that the three factors will be considered in merger assessment. Such confirmation could be found in specific guidelines or future case decisions. In addition, assessment of coordinated effect in China relies too much on the extent of market concentration and the number of remaining competitors. This may possibly lead to false negative errors.¹⁴² In order to avoid these, the MOFCOM should consider more factors apart from market concentration. If majority market shares are concentrated in the hands of two or three competitors, the MOFCOM should further investigate product homogeneity, market transparency, and the stability of demand and supply conditions in the market which may prevent remaining firms from reaching terms of coordination tacitly. On the other hand, coordination has so far all been in the form of parallel price. Other forms of synergy have not to date, July 2013, been pointed out by the MOFCOM.¹⁴³ If products are heterogeneous and the market is not transparent, the antitrust authority should still determine whether there are other forms of coordination apart from price collusion, or false positive errors may occur.¹⁴⁴ Finally the MOFCOM should assess retaliation mechanisms for the sustainability of coordination. There should be a potential relation mechanism within coordination, in order to detect deviations.¹⁴⁵

'External factors' in the EU involve the reaction of outsiders to potential entry, fringe competitors and countervailing buyer power. To sum up, this analytical

¹⁴⁰ For suggestions see '4.2.7 Improving Communication amongst the MOFCOM, Notifying Parties and the Third Parties' in chapter 3.

¹⁴¹ See '2.2.1 Reaching Terms of Coordination' in this chapter.

¹⁴² See the first point in '2.1.1 General Checklists' of this chapter.

¹⁴³ Apart from coordination on price, forms of coordination also include coordination on capacity, customer sharing, multimarket contacts. See S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, *supra* note 4, 203.

¹⁴⁴ Other forms of coordination are available in the introduction of this chapter, *supra* note 4 to 7.

¹⁴⁵ In considering the retaliation mechanism the MOFCOM should be attentive to the speed of detection and punishment, as well as the incentive of firms to implement retaliation. The specific analysis is available in '2.2.3 Deterrent Mechanism' of this chapter.

framework for analysing coordinated effects is in line with the thinking in economic theories, and is also suitable for the assessment of coordination in China.¹⁴⁶ The MOFCOM should accept this approach in case decisions or guidelines. In order to get more information on the concerns of coordinated effects the MOFCOM should also expand channels for hearing views of notifying parties as well as related third parties.¹⁴⁷ Besides, in their investigation the MOFCOM should not consider every factor exclusively. Some specific market characters will affect more than one factor composing the analytical framework of coordinated effects. For example, the structural links between coordinating firms help them to reach terms of coordination, but reduce incentives for retaliation.¹⁴⁸ Therefore the MOFCOM should learn to interpret the effects of a market character on the likelihood of tacit collusion from different aspects.

4.2 Analysis of Causal Link

The MOFCOM does not reveal its investigation of market situations pre-merger. It only gives an indication of the market situation after a merger.¹⁴⁹ In order to identify the likely anti-competitive effects made possible by a merger it would be desirable to compare the market equilibrium before the merger with what is expected to emerge following it.¹⁵⁰ This would show whether a collective dominant position has existed before the merger and whether the notified transaction is a

¹⁴⁶ These criteria are closely aligned with contemporary thinking in industrial economics as well as US practice. See M Motta, *Competition Policy: Theory and Practice*, (Cambridge University Press, 2004), pp. 137-185.

¹⁴⁷ Communication between the MOFCOM and related parties has been discussed in Chapter 3.

¹⁴⁸ See point five in '2.1.1 Reaching Terms of Coordination'.

¹⁴⁹ In *Uralkali/Silvinit* the MOFCOM only cited a high concentration of market share post-merger as the reason for its arbitration. C L Hannah and J M Hickin, *China Imposes Conditions on Uralkali/Silvinit Merger after Anti-monopoly Review*, (June 2011), *Mayer Brown Legal Update*, 3, available at: <http://www.mayerbrown.com/zh-CHS/publications/China-Imposes-Conditions-on-UralkaliSilvinit-Merger-after-Anti-monopoly-Review-06-08-2011/> (accessed on the 23rd April 2013). B Yong and D Ninette, *Horizontal mergers in the China context: The Uralkali/Silvinit potash merger and continuity of supply obligations*, (August 2013), *Clifford Chance Legal Update*, available at: http://www.cliffordchance.com/publicationviews/publications/2011/08/horizontal_mergersinthechinaco-nextth.html (accessed on the 23rd April 2013). M Han and M Wang, *MOFCOM conditionally clears Uralkali's acquisition of Silvinit*, (June 2011), *Freshfields Bruckhaus Deringer LLP Legal Update*, available at: <http://www.lexology.com/library/detail.aspx?g=cda5cf6b-ce31-4d12-99c2-1751d88c0506> (accessed on the 23rd April 2013).

¹⁵⁰ S Bishop and A Lofaro, *supra* note 4, pp. 195-242.

decisive factor in creating or strengthening a collective dominant position.¹⁵¹ In addition, the market situation pre-merger has a close relationship with the burden of proof. It is intuitive that the more competitive the market is pre-merger, the more dramatic the change arising from the merger has to be to justify the collective dominance finding.¹⁵²

There are various modes of assessment of the causal link of coordinated effects. One assumes that tacit coordination is unlikely even after a merger. The authority should as a first step find factors which deter successful coordination. The second step is to prove those deterring factors will not be changed significantly by a merger. In contrast, the other approach assumes that coordination is possible after a merger. The authority should then prove those factors conducive for coordination will be strengthened by a merger.¹⁵³ The latter approach is considered much harder to establish, as there are no specific market characteristics or economic theory that can presume that coordination will definitely occur in future.¹⁵⁴ Therefore the assumption of a potential positive test is easily overturned. It is relatively easy to reject the assumption of collective dominance according to a former negative test.¹⁵⁵ In order to ensure legal certainty the MOFCOM should have an impartial attitude to investigating the market situation pre-merger and should ascertain whether coordination has existed. If evidence of past practice indicates that tacit collusion is unlikely, the MOFCOM should find what constrains competitors' incentives and ability to coordinate their actions. It needs then to see how the proposed merger will change those existing barriers to coordination.¹⁵⁶ At the same time it should be aware that evidence of past practice might not be a good guide

¹⁵¹ If there is past coordination pre-merger, then it is important for the approval of a merger if the relevant market characteristics have not changed significantly or are unlikely to do so in the future. In the EU there was a debate on whether mergers should be prohibited if there was coordination in the market pre-merger. This issue has been acknowledged by the General Court, which states: If there is no significant change in the level of competition obtaining previously, the merger should be approved because it does not restrict competition. See paragraph 82, Case T-342/99 *Airtours v Commission* [2002] E. C. R II-02585.

¹⁵² See General Court on *Airtours/First Choice*, *ibid.*

¹⁵³ K Kühn, *Closing Pandora's Box? Joint Dominance after the "Airtours" Judgment*, *supra* note 44, 68.

¹⁵⁴ *Ibid.*

¹⁵⁵ *Ibid.*

¹⁵⁶ A R Dick, *Coordinated Interaction: Pre-merger Constraints and Post-merger Effects*, *supra* note 61, 70.

to the future. The facts of pre-merger may not be decisive if the market situation has changed. On the other hand, although the market is (relatively) competitive pre-merger, a merger may make it (relatively) uncompetitive because of coordinated effects.

A causal link is determined to ascertain the change of merger to competitive process through investigating various chains of cause and effect.¹⁵⁷ From the evidence of the EU,

First, coordination will be more likely post-merger if the transaction: a. reduces the number of independent decision-makers; b. removes a ‘maverick’ company; c. removes a supplier who has a history of disrupting coordination by under-pricing rivals or refusing a market leader’s pricing; second, coordination will be more complete post merger if the transaction: a. supports a higher coordinated price by creating a market leader so it can control coordination more easily; b. removes a source of independent pricing variation from the market; thirdly, coordination will be more stable if transaction enlarges the competitors’ overlap which enables suppliers to support coordinated pricing against a larger population of buyers for more products or for a longer duration.¹⁵⁸

In addition, opportunity for innovation can constrain coordination, and a merger can facilitate coordination by limiting innovation; non-transparency can constraint coordination, and a merger can facilitate coordination by increasing transparency among coordinating parties.

¹⁵⁷ Many articles criticise the probable effects of a merger on market competition. The changes of merger have four aspects: firstly, merger affects the degree of asymmetry of the market shares of the various firms; secondly, merger removes a ‘maverick’ firm; thirdly, merger may enhance the partitioning of the market; fourthly, merger increases the risk of tacit collusion by increasing suppliers’ retaliation possibilities. See Section III-3 How does the merger change matters? in S Bishop and A Lofaro, A legal and economic consensus? The theory and practice of coordinated effects in EC merger control, *supra* note 4, pp.217-220.

¹⁵⁸ A R Dick, Coordinated Interaction: Premerger Constraints and Post-merger Effects, *supra* note 61, pp. 65-88.

4.3 Improving the Standard of Proof

4.3.1 Does the standard of proof need to be improved?

The standard of proof that ‘the possibility cannot be ruled out’ in China should be improved, for at least the following reasons:

Firstly, merger decisions may be false negative if coordination is not the ‘the most likely’ situation post-merger.¹⁵⁹ The General Court in *EDP v Commission* also confirmed that the Commission cannot ‘sit on the fence’ and rely on doubt in prohibiting a merger.¹⁶⁰

Secondly, a false negative decision can hardly be annulled through administrative reconsideration or judicial review in China.¹⁶¹ In the development of coordination assessment the European Court plays a substantial role. Through judicial review an initial framework for coordination assessment was established.¹⁶² Cases which did not meet the standard of proof were corrected. The Commission’s practice of merger control is externally monitored by the Court.¹⁶³ By July 2013 there had been no record of any judicial review of the MOFCOM’s merger decisions. There might be at least two explanations of this failure. The first is that the appeal process before the Court is seen as extremely lengthy (in any case too long for the parties of a merger to wait), and the antitrust authority enjoys a significant level of discretion in its application of economic analysis in merger decisions.¹⁶⁴ The second is the lack

¹⁵⁹ One example is that the same transaction in *Seagate/Samsung* received different decisions in the EU and China. For further discussion see ‘3.1 Checklist Period in China’ in this chapter.

¹⁶⁰ See Case T-87/05, *EDP-Energias de Portugal v Commission*, [2005] E.C.R. II-3745, paragraph 64,

¹⁶¹ See ‘4.2.3 Ineffectiveness of Judicial Review’ in Chapter 1.

¹⁶² See *supra* note 45.

¹⁶³ The most significant example is *Sony/BMG*. It was called the second most important case in the development of assessment of coordinated effect in the EU, following *Airtours/First Choice*. This case was cleared outright by the Commission at first. As a third party *Impala* appealed this decision before the General Court which overturned the Commission’s clearance decision because of ‘manifest errors’ in assessment. The merging parties appealed against the General Court’s judgment before the CJEU. At last the CJEU approved the Commission’s first decision and cleared the transaction. During this process of judicial review the standard of proof for the Commission’s assessment was clarified and improved.

¹⁶⁴ This is common sense both in the EU and China. For a long time it has also been commonly believed that the decisions of the EU appraising mergers have not been fully subjected to

of an independent judiciary and the tradition of obeying the orders and decisions of the government; administrative decisions are seldom challenged in China.¹⁶⁵ Thus interpretation or correction of a merger assessment through the courts is absent in China.¹⁶⁶ Due to a lack of external supervision parties in merger decisions which are made in doubt or even in error may have no recourse to appeal. The MOFCOM itself needs to collect ‘cogent evidence’ in order to ensure that coordination is the ‘most likely’ consequence.

Thirdly, the current standard of proof in China places an undue burden of proof on the notifying parties. In the EU the notifying parties need only prove that a merger would make coordination less likely when pre-merger coordination has been identified by the authority. In such a situation the notifying parties only need prove the merged entity increases market asymmetry or becomes a ‘maverick’ firm because it becomes more effective after merger.¹⁶⁷ It is relatively easy for the notifying parties to demonstrate the efficiencies which will be secured by merger alone. In China the MOFCOM places the burden of proof on the notifying parties as long as the MOFCOM raises a concern that the merger may create coordination or make it more likely, sustainable or easier. The authority has the discretion to block a merger even if there are insufficient data to support this view.¹⁶⁸ In most instances the MOFCOM’s concerns about coordination were indeed not supported by sufficient evidence. It is worse to combine such discretion with ineffective judicial review and the MOFCOM’s relationship with industrial policy.¹⁶⁹ The low standard of proof may become a shield for the MOFCOM to consider non-competitive matters

substantive judicial review. See F Todorov and A Valcke, Judicial review of merger control decisions in the European Union, (2006) Volume 51 Issue 2, *Antitrust Bulletin*, 339; M Clough, The Role of Judicial Review in Merger Control, (2003-2004) Volume 24 Issue 3, *Northwestern Journal of International Law and Business*, pp. 729-754;

¹⁶⁵ See Q Bu, Anheuser-Busch/InBev: the legal implication under the AML 2008, (2010) Volume 31 Issue 6, *E.C.L.R.*, 245. Ineffective judicial review provides the background to merger assessment in China. It has been introduced in ‘4.2.3 Ineffectiveness of Judicial Review’ of chapter 1.

¹⁶⁶ See also E M Fox, An Anti-Monopoly Law for China-Scaling the Walls of Government Restraints, (2008) Volume 75, *Antitrust Law Journal*, pp. 175-177.

¹⁶⁷ This is similar to the claim that a merger makes coordination less likely.

¹⁶⁸ See A Emch et al., MOFCOM Imposes Divestiture Obligation in Its Approval of Private Equity Transaction, *supra* note 124; L Wong, MOFCOM’s Conditional Approval for Penelope’s Acquisition of Savio, *supra* note 128.

¹⁶⁹ Ineffective judicial review and the MOFCOM’s mission of enforcing industrial policy have been discussed in ‘4.2 Market Situation for the Implementation of Merger Control in China’ in Chapter 1.

behind. The court has no standing to correct the MOFCOM's decision either. On the other hand, compared with the authority, the notifying parties have far fewer resources with which to conduct investigations than the antitrust authority. Under the procedural rules applicable under the AML 2008, the merging parties do not have any rights to obtain evidence from third parties, but the MOFCOM has extensive powers to do so.¹⁷⁰ The antitrust authority has more power to collect evidence and determine the 'most likely' situation. Therefore it is recommended that the MOFCOM makes clear that the burden of proof is placed onto the notifying parties only when it needs to counteract the MOFCOM's pre or post-coordinating concerns with sufficient evidence.

4.3.2 Is a 'Symmetric' Standard of Proof Suitable for China?

If the standard of proof in China needs to be improved, the next question is whether a 'symmetric' standard of proof is suitable for China. In the EU, in line with the 'most likely' standard, the court requires the Commission to use a 'symmetric' approach in assessing a merger which raises coordination concern.¹⁷¹ Requirements of the 'symmetric' approach are as follows:

i) Bearing a neutral attitude, of no bias against or in favour of the legality of mergers from the outset of merger review.¹⁷² This is to ensure the legal certainty that a merger decision will be permanent, and the Commission's analysis can withstand judicial scrutiny. In order to ensure certainty of a merger decision the MOFCOM should also bear a neutral attitude in a merger review. But the

¹⁷⁰ For the powers of the MOFCOM in investigating mergers see Chapter 6 of the AML 2008 as well as the MOFCOM announcement [2011] No. 6 Interim Measures on Investigation into and Handling of Concentrations of Business, which was promulgated by the MOFCOM on the 30th December 2011, and took effect on 1st February 2012.

¹⁷¹ See K Wright, Perfect symmetry? *Impala v Commission and standard of proof in mergers*, *supra* note 81, 408.

¹⁷² In the EU the CJEU states that 'it cannot be inferred from the Regulation that there is a general presumption that a notified concentration is compatible with, or incompatible with, the common market.' Therefore the Commission cannot choose a clearance decision to be on the safe side. Rather, it still needs a fully reasoned decision based on sound evidence.' See point 48, Case C-413/06p, *Bertelsmann AG and Sony Corporation of America v Independent Music Publishers and Labels Association (Impala)*, [2008] E.C.R. I-04951; B V Rompuy, the Standard of Proof in EC Merger Control: Conclusions for the Sony BMG Saga, (December 2008), *Institute for European Studies Working Paper No. 4/2008*, 16, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1577772 (accessed on the 1st November 2012).

‘symmetric’ standard might be too high to be implemented in China currently. The first barrier to its application is the MOFCOM’s limited resources. In applying the ‘symmetry’ standard the authority must either prove to the required standard that post-merger coordinated effects will occur, or it must prove to the same standard that post-merger coordinated effects will not occur. This requisite legal standard for authorising a merger is even believed too high to be practised by the Commission in the EU.¹⁷³ Compared with the EU, the MOFCOM in China has far fewer resources and experience which might not meet the standard.¹⁷⁴ However, the MOFCOM still has room for improvement. Firstly, the MOFCOM is expected to provide a consistent analytical framework for analysing coordinated effects in a public case as the judgment of the court in *Airtours/First Choice* in the EU. The MOFCOM could reduce the requirement of evidence collection in merger cases which are compatible with market competition. The MOFCOM should publish its every clearance decision and give simple reasons for them.¹⁷⁵ Thus more time and resources could be applied to complicated cases. Such an imbalance in the standard of proof cannot last long; relaxed criteria for clearing a merger may lead to unfounded prohibition decisions. In the long run, as the MOFCOM becomes more experienced in investigation and balancing various possibilities, the standard of proof for clearing a merger should be increased to the same level as decisions of significant coordinated concern.

¹⁷³ This ‘symmetric’ standard is criticised for wasting too much review time and put too much burden of proof on merging parties. Regarding transactions which raise no coordination concerns, notifying parties are still required to prepare many documents in order to reach the EU’s standard of proof. A Nucara, Standard of Proof and Scope of Judicial Review in EC Merger Cases: Everything Clear after Tetra Laval?, *E.C.L.R.*, (2005) Volume 26 Issue 12, pp. 692-704; H Rosenblatt and P VOsch, BMG-SONY merger Reversal highlights burden of proof, (July 2008), *Competition Law* 360, available at: <http://www.law360.com/articles/63358/bmg-sony-merger-reversal-highlights-burden-of-proof> (accessed on the 23rd April 2013).

¹⁷⁴ B V Rompuy, the Standard of Proof in EC Merger Control: Conclusions for the Sony/BMG Saga, *supra* note 174, 6.

¹⁷⁵ At present the MOFCOM collects very detailed information on the market situation in notified mergers, even if cases raise no serious competition concerns. The MOFCOM’s resources are dispersed, and clearance decisions cannot get approval timely. This problem is expected to diminish as merger parties gain experience and learn what information is essential to merger assessment, and the MOFCOM applies different evidence criteria to mergers which raise different competitive concerns. See N H F Chang *et al.*, (Mayer Brown JSM), China: Antimonopoly Law, *The Asia-Pacific Antitrust Review 2012*, available at: <http://globalcompetitionreview.com/reviews/42/sections/146/chapters/1643/> (accessed on the 23rd April 2013).

ii) Balancing of various probabilities before making a decision in merger cases in a 'grey area'. As the standard of proof concerning the establishment of collective dominance is high, there arises a situation in which the evidence is not sufficient to meet these requirements. Within the 'grey area', it is difficult to foresee the effects of a notified transaction and consequently it is difficult to arrive at a decision whether the merger would create or strengthen a collective dominant position.¹⁷⁶ The larger the 'grey area', the less legally certain is the final decision. One opinion in the EU suggests clearing cases within a 'grey area'. Advocate General Tizzano in *Tetra Laval II* made three points on this:

First, Article 10(6) of the Merger Regulation 4064/89 (now Article 10(6) EUMR) stipulates that if the Commission does not make a decision within the deadlines, the merger shall be deemed compatible with the common market. Secondly, there should be a presumption in favour of authorisation so as not unjustifiably to restrain the parties' freedom of economic activity. Finally, if a merger is authorised which subsequently turns out to have significant anti-competitive effects (i.e. the Commission makes a false positive error), the Commission has an instrument with which to correct these *ex post* in the form of Article 102 of the Treaty.¹⁷⁷

When considering the deterrent effect of Article 102 the Commission does not have to establish that the post-merger behaviour of the parties would actually constitute an abuse of a dominant position. The constraint of Article 102 is to eliminate the likelihood of such behaviour on balance of probability.¹⁷⁸ If the

¹⁷⁶Note 149 in V R Ben and P Caroline, Is the standard of proof imposed by the Community Courts undermining the efficiency of EC merger control? The SONY/BMG joint venture case in perspective, (May, 2007), *EUSA Tenth Biennial International Conference*, 24, available at: <http://aei.pitt.edu/8013/1/rompuy-b-02g.pdf> (accessed on the 25th October 2012),

¹⁷⁷Opinion of Advocate General Tizzano—CASE C-12/03 P *Commission v. Tetra Laval*, (25th May 2004), available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003CC0013:EN:PDF> (accessed on the 23rd April 2013).

¹⁷⁸Reasons supporting the authorisation of cases in the 'grey area' still include: (i) that (re-) combinations of assets by rational market agents normally increase efficiency and (ii), therefore, enterprises and entrepreneurs have the basic right freely to combine their assets, then policy interventions in this type of market activity should be restricted to cases in which losses in social welfare due to anti-competitive effects either outweigh the benefits of the gaining producers (total welfare standard) or unduly exploit consumers (consumer welfare standard). See K Wright, Perfect symmetry? *Impala v Commission* and standard of proof in mergers, *supra* note 81, 411.

Commission clears an ambiguous coordinated effects case (or imposes sharp remedies), the false negative cases are reduced. However, expected anticompetitive mergers leading to a collusive post-merger equilibrium cannot be prohibited or adequately modified only because the effects cannot be proven according to the required standard of proof. Consumer welfare is expected to suffer because of these false positive errors.¹⁷⁹

To date, with the standard of proof in the EU, evidence supporting the concerns of coordinated effects in China is not ‘cogent’. However, the MOFCOM still raised the concern and added sharp commitments to the notified mergers. The decisions have resulted in false negative errors which are never corrected through judicial review.¹⁸⁰ The MOFCOM should balance every possibility before clearing a transaction in a ‘grey area’. Firstly, the MOFCOM has opportunities to practise merger assessment on coordinated effect. It is vital for a young authority to accumulate experience. Besides, more qualitative and quantitative tests will be introduced in order to compare each possibility and get a ‘most likely’ result. As judicial review in China is ineffective, the MOFCOM does not need to take the risk of legal uncertainty as does the EU. The MOFCOM’s final decision will not be annulled by the Court.

iii) The standard of proof should be same for finding an existing or potential collective dominant position.¹⁸¹ In *Impala* the General Court suggested that

¹⁷⁹ See L Prete and A Nucara, Standard of Proof and Scope of Judicial Review in EC Merger Cases: Everything Clear after Tetra Laval?, (2005) Volume 26 Issue 12, *E.C.L.R.*, pp692-704.

¹⁸⁰ Compared with ? / Unlike ? false negative error, the effects of MOFCOM’s false positive decision are more likely to be modified by the court. The MOFCOM may wrongly clear a merger, which leads to a single or collective dominance in the market. According to Chapter 3 of the AML 2008 affected parties can lodge a lawsuit if the leading firm(s) abuses its/their dominant position post-merger. There have been successful lawsuits on the abuse of dominant position in China. For example, the National Development and Reform Commission fined two pharmaceutical companies for abusive conduct, see S Ninget al., NDRC Fined Two Pharmaceutical Companies for Abusive Conduct, (December 2011), *King and Wood*, available at: <http://www.chinalawinsight.com/2011/12/articles/corporate/antitrust-competition/ndrc-fined-two-pharmaceutical-companies-for-abusive-conducts/>. More details on private action pursuant to Chapter 3 of the AML 2008 can be seen in NHF Chang et al., (Mayer Brown JSM), China: Antimonopoly Law, *supra* note 177.

¹⁸¹ The facts and evidence adduced to clear a merger are broadly symmetric with the facts and evidence cited to prohibit it. In *Sony/BMG* on the symmetrical standard of proof the CJEU asserted that there is no need to presume the transaction is compatible with the market. No matter whether the merger will be cleared or prohibited, it should be proved with ‘cogent evidence’. See point 50, Case C-413/06p, *Bertelsmann AG and Sony Corporation of America v Independent Music Publishers and*

conditions for a finding of collective dominance in the *Airtours* case could more easily be satisfied in the investigation of a pre-existing collective dominant position than in the investigation of the potential creation of such a position.¹⁸² The Court of Justice of the European Union did not object to this view. It stressed that:

It is necessary to avoid a mechanical approach involving the separate verification of each of those criteria in isolation, while taking no account of the overall economic mechanism of a hypothetical tacit coordination.¹⁸³

Quite in contrast to the claim that *Impala* imposed too high a standard of proof on the Commission, the General Court and the CJEU in fact lowered the evidentiary threshold for establishing an existing collective dominant position.¹⁸⁴ In China the MOFCOM did not find evidence of existing collective dominance pre-merger. All concerns are based on possibilities of potential collective dominant position post-merger. It is unknown how the MOFCOM will prove the existence of collective dominance pre-merger. The MOFCOM should publish its presumption based on collected direct evidence, as the unrevealed process of presumption might render the outcome of existing collective dominance legally uncertain within which the MOFCOM can have non-competitive considerations.

In conclusion, in order to assess coordinated effect more precisely the MOFCOM should expand its checklist rather than just factors of market concentration and

Labels Association (Impala), [2008] E.C.R. I-04951. See also B V Rompuy, Implications for the standard of proof in EC merger proceedings: Bertelsmann and Sony Corporation of America v. Impala, *supra* note 68, 612.

¹⁸² The CJEU deviated from this substantive test in stating that: 'Although the three conditions are indeed also necessary, they may, however, in the appropriate circumstances, be established indirectly on the basis of what may be a very mixed series of indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position. Thus, in particular, close alignment of prices over a long period, especially if they are above a competitive level, together with other factors typical of collective dominant position, might, in the absence of an alternative reasonable explanation, suffice to demonstrate the existence of a collective dominant position, even where there is no firm direct evidence of strong market transparency, as such transparency may be presumed in such cases'. See paragraph 252, case C-413/06p, *Bertelsmann AG and Sony Corporation of America v Independent Music Publishers and Labels Association (Impala)*, [2008] E.C.R. I-04951.

¹⁸³ Point 5, Case C-413/06p, *Bertelsmann AG and Sony Corporation of America v Independent Music Publishers and Labels Association (Impala)*, [2008] E.C.R. I-04951.

¹⁸⁴ B V Rompuy, Implications for the standard of proof in EC merger proceedings: Bertelsmann and Sony Corporation of America v. Impala, *supra* note 68, 611.

number of competitors. In order to operate a tacit collusion in the long run the MOFCOM should point out market characteristics which are conducive to internal monitoring and timely retaliation in coordination. Nevertheless, an expanded checklist is not just a burden for the MOFCOM. Merging parties can also raise more countervailing market characteristics to eliminate coordinated concerns raised by the MOFCOM.¹⁸⁵ The checklist approach also has unavoidable drawbacks in reflecting coordinated concern and legal certainty. The MOFCOM should adopt an analytical framework like that of the EU, as it brings more legal certainty and transparency to the public.¹⁸⁶ Regarding the standard of proof on coordinated effect, the MOFCOM's should not be lower than that of the EU in the long run. This is because of the ineffectiveness of the external judicial review, and a closer relationship between the antitrust authority and the government, which has an obligation to enforce non-competitive considerations.¹⁸⁷ For example, when proving the existence of collective dominance pre-merger the MOFCOM should publish its presumption based on direct evidence. On the other hand, according to the historical development of coordinated assessment in the EU, the approach in China still needs more time to accumulate experience and become mature.¹⁸⁸ Therefore the standard of proof in the EU seems too high to be practised in China currently. Due to the tight reviewing period and limited experience of the MOFCOM, mergers raising no significant coordination concern can be cleared with a simple notice. Thus the MOFCOM will soon be able to have more resources and time in which to offer explicit explanations of cases which raise significant concern as to coordination.

¹⁸⁵ The parties to the concentration are encouraged to submit evidence to the MOFCOM with a view to rebut objections raised as soon as possible, since the MOFCOM would have enough time to carry out the necessary investigation.

¹⁸⁶ See '2.2 Assessment under a Fixed Framework' in this chapter.

¹⁸⁷ These two characteristics have been analysed in chapter 1 as the background of merger assessment in China.

¹⁸⁸ Historical development of the assessment of coordinated effects in merger control of the EU has been introduced in '4.1 Establish Analytical Framework' in this chapter.

Chapter 5: Countervailing Factors: Buyer Power and Market Entry

1 Introduction

After delineating the relevant market and the anti-competitive effects of a merger the third step is to see if there are any countervailing effects which can offset anti-competitive concerns.

The aim of this chapter is to examine the countervailing factors in China's antitrust merger assessment. In particular, there are three questions to be posed: 1. How are countervailing factors evaluated in China's antitrust merger control? 2. What is the experience of the EU in analysis of countervailing effects in horizontal-merger control? 3. What can be learned from the experience of the EU to improve the assessment of countervailing factors under China's merger control regime? This chapter focuses on two countervailing factors, namely countervailing buyer power¹ and market entry.²

¹It only concerns the power of the downstream purchaser to restrain the market power of the merging parties. The effect of the buyer power of the merged entity in curbing the supplier market will not be discussed here since it does not relate to any countervailing factor to restrain market power of the merged entity.

²Other countervailing factors of anti-competitive concern include efficiency created by the merger, failing firm defence, national economic development and public interest in China. Mark Furse states 'the assessment of countervailing factors in China has not been developed to any significant degree. The checklist in the AML and guidance is of limited value, and has not been significantly clarified in practice'. Especially, there is no evidence published concerning efficiency arguments or failing firm defence that have influenced MOFCOM in any particular case. Therefore, he said 'it is not possible at the time of writing to draw any conclusions relating to the efficiency or failing firm defences'. M Furse, Merger Control in China: Four and a Half Years of Practice and Enforcement-A Critical Analysis, (2013) Volume 36 Issue 2, *World Competition: Law and Economics Review*, pp. 288-289.

2 Countervailing Buyer Power

2.1 Countervailing Buyer Power in the EU

According to the Guidelines on Horizontal Mergers in the EU countervailing buyer power should be understood as ‘the bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations due to its size, its commercial significance to the seller and its ability to switch to alternative suppliers’.³ Big buyer power can restrain unilateral price increase by the merged entity or reduce the threat of upstream collusion.⁴ The Commission takes three steps to evaluate countervailing buyer power.

2.1.1 The Existence of Viable Alternatives or Credible Threats

Once buyers find out the price increase they may adopt certain strategies to counteract the merged entity’s supra-competitive pricing. The premise of this conduct is the existence of viable alternatives or credible threats. In general, viable alternatives or credible threats may be divided into three kinds. The first happens when buyers switch to other suppliers or sponsor a new entry;⁵ the second

³Paragraph 64, Guidelines on Horizontal Mergers. A Pera and V Bonfitto, Buyer power in anti-trust investigations: a review, (2011) Volume 32 Issue 8, *E.C.L.R.*, pp. 414-425; J Tirole, *the Theory of Industrial Organization*, (The MIT Press, 1988), 305; A Lofaro and S Baker, Buyer power and the Enso/Stora decision, (2000) Volume 21 Issue 3, *E.C.L.R.*, pp. 187-190; A Lindsay *et al.*, Econometrics study into European Commission merger decisions since 2000, (2003) Volume 24 Issue 12, *E.C.L.R.*, pp. 673-682; M L Steptoe, the Power-Buyer Defence in Merger Cases, (1992-1993) Volume 61 Issue 2, *Antitrust Law Journal*, pp. 493-504; J B Nordemann, Buying power and sophisticated buyers in merger control law: the need for a more sophisticated approach, Volume 16 Issue 5, *E.C.L.R.*, pp. 270-281; R D Blair and J L Harrison, Antitrust Policy and Monopsony, (1991) Volume 76, *Cornell Law Review*, pp. 303–306; Y S Choi and K Fuchikawa, Comparative Analysis of Competition Laws on Buyer Power in Korea and Japan, (2010) Volume 33 Issue 3, *World Competition*, 514; I Kokkoris, Buyer Power Assessment in Competition Law: A Boon or a Menace, (2006) Volume 29 Issue 1, *World Competition*, pp.139-164.

⁴ A big buyer can withdraw or threaten to withdraw its order from merging parties in order to restrain its unilateral price increase. In addition, orders from a big buyer can make the collusion of suppliers unstable, since any member may intend to get the contract with big buyer even deviating the terms of coordination.

⁵In *Pirelli/BICC* the relevant product market of transaction was the production and sale of power cables to energy utilities. The European Commission cleared the acquisition as the downstream buyers (energy utilities) still can switch to at least four alternative suppliers if Pirelli/BIC were to apply anti-competitive prices. Successful switching was promised by energy utilities’ substantial purchasing power. They have the possibility to attract additional cable suppliers through strategic allocation of

when buyers start manufacturing their own input products or increase purchasing their own input products;⁶ and the third when a buyer threatens to initiate either of the above actions.⁷

In order to be credible threats the loss of buyers' order should make the merged entity's price increase unprofitable post-merger.⁸ Therefore the buyers' purchasing volume should be substantial, taking a large percentage of the suppliers' output. Only in exceptional conditions, when large capacity is necessary for the suppliers to be profitable, a small volume of switch is enough to threaten the price increase of suppliers.⁹ Even in the EU countervailing buyer power is insufficient to moderate a highly concentrated market on its own. Instead, it mostly serves as a competitive constraint together with other countervailing factors.¹⁰

2.1.2 The Incentive of Buyers to Act

However, the existence of credible suppliers does not mean buyers would choose to switch supply. They may still face a number of risks. Buyers should bear the risk of reputational and reliability factors if they switch suppliers to constrain the price increase of the merged entity.¹¹ Buyers may need a period of time in order to test if

orders and thus to broaden their supplier base if necessary. See Case IV/M.1882 Pirelli/BICC, [2003] O.J. L70/35, point 76.

⁶Steptoe notes that Coca Cola organised a joint venture to produce plastic bottles itself after failing to negotiate a price reduction from their original suppliers. Prices on bottles fell by about 33 per cent afterward. See M L Steptoe, *the Power-Buyer Defence in Merger Cases*, *supra* note 3, 499. This case also indicates that, if a new entry is easy, even credible suppliers are shortage among incumbent firms; it does not mean the buyer power is weak.

⁷These three kinds of viable alternative or credible threat are illustrated in paragraph 64, Guidelines on Horizontal Mergers. They are also confirmed by other jurisdictions and articles. See I Kokkoris, *Buyer Power Assessment in Competition Law: A Boon or a Menace*, *supra* note 3, 142.

⁸The same conclusion can also be seen in paragraph 65, Guidelines on Horizontal Mergers.

⁹In *Enso/Stora*, merging parties operated in the production of liquid packaging board which is a high fixed-cost industry, where high rates of capacity use are necessary in order to achieve satisfactory levels of profitability. The Commission noted that the merged entity would find it hard to find other customers in the short term if it were to lose the large volumes purchased by its largest customer. Therefore the Commission considered that buyer power was sufficient to remove the possibility of the parties' exercising market power. See Case IV/M.1225 *Enso/Stora* [1999] O.J. L254/9, points 90 and 97.

¹⁰Evidence from EU cases can be seen in A Lindsay, *The EC Merger Regulation: Substantive Issues*, (Sweet & Maxwell, 2006), 468.

¹¹M L Steptoe, *the Power-Buyer Defence in Merger Cases*, *supra* note 3, 498. In *CVC/Lenzing*, the European Commission prohibited the transaction since it would have led to very serious competition

the new supplier is fit for the required standard in the aspects of duration, purity or other factors. If buyers enter into the upstream market themselves or sponsor a new entry, they may face a giant sunk cost for buying large capacity costs, spending time on controlling complex manufacturing processes, or getting a licence or patent.¹²In order to encourage the expansion of a rival's production or entry into an upstream market, the buyer will have to promise some form of long-term contract relationship before the new supplier has proved its capability. The buyers have to take risks such as the new suppliers' not being able to fulfil a contract on time, meet required quality, attain the necessary production schedules and so on.¹³Especially when a price reduction after a switch or entry will also be enjoyed by rivals, buyers may be reluctant, leading to 'free-riding' or 'first-mover disadvantage' situations.¹⁴

According to Lindsay buyers are believed to have a greater incentive to exercise any power that they may have if the benefit is substantial:

- a) When the buyers' purchases represent a large proportion of their input costs, the buyer will generally be more price-sensitive and more willing to shop around.
- b) When the end-product market is itself competitive, there will commonly be no or limited scope to pass through increases in input costs.
- c) When there is competition in a downstream market a purchaser of an input

concerns in the production of viscose staple fibres (viscose). The downstream big tampons manufacturers had insufficient buying power effectively to constrain the independence of competitive behaviour of the merged entity. These companies are to a large extent 'locked in' by high switching costs. See case COMP/M.2187 CVC/Lenzing, [2004] O.J. L82/20, point 223.

¹²In *Alcatel/Finmeccanica/Alcatel Alenia Space & Telespazio*, as a buyer of merging parties, ESA had countervailing power through creating a new independent supply source for the future. However, the Commission excluded the possibility that the ESA would do so as 'it would be difficult and costly for Astrium to gain radar altimeter expertise without having access to the expertise of either Alcatel or Alenia'. Finally, the Commission concludes that 'there would be no alternative that could act as a reference point to which the parties' prices and product performance could be compared'. See Case COMP/M.3680 *Alcatel/Finmeccanica/Alcatel Alenia Space & Telespazio*, [2005] O.J. C139/37, paragraph 86.

¹³A Pera and V Bonfitto, Buyer power in anti-trust investigations: a review, *supra* note 3, 414. Nevertheless, if the contract is elastic, the certainty of the new entry will be reduced accordingly. ML Steptoe, the Power-Buyer Defence in Merger Cases, *supra* note 3, 498.

¹⁴Introducing a new entry may involve significant costs. The buyer's competitors will be able to reap the benefit of new competition without, however, contributing to the costs. This situation is called 'free riding' or 'first-mover disadvantages'. See paragraph 66, Guidelines on Horizontal Mergers; See also A Pera and V Bonfitto, *ibid*, 501.

used to produce one of the products sold on that market but not others is more likely to restrain the conduct of the supplier of the input, because the purchaser has an incentive to control cost which cannot be passed on.¹⁵

Steptoe also proposed two conditions when buyers are able to be well-informed that the sellers' prices are supra-competitive. Firstly, buyers' cost is largely determined by raw materials that trade at known and publicly reported market prices. Secondly, the supra-competitive price is more likely to be recognised if it is increased in a large jump than incrementally.¹⁶

In addition, buyers of merging parties may not be the final customers. If they are intermediate producers, they should promise to pass the input savings onto the final customers.¹⁷ Fierce price competition in the downstream market can force intermediate retailers to pass the cost reduction onto final customers.¹⁸

¹⁵ For more EU cases, see notes 50 and 51, A Lindsay, *The EC Merger Regulation: Substantive Issues*, *supra* note 11, pp.473-474. In addition, as the expense of purchase may take a large percentage of input cost to smaller buyers, they have greater incentive to negotiate with suppliers. Consequently they even receive better prices. This is another demonstration of benefit's encouraging the exercise of buyer power. See point 5.62 in PricewaterhouseCoopers Ex post evaluation of mergers, Report prepared for the OFT, DTI and Competition Commission, (March 2005), available at: http://www.of.gov.uk/shared_of/reports/comp_policy/of767.pdf (accessed on the 22nd February 2013).

¹⁶ ML Steptoe, the Power-Buyer Defence in Merger Cases, *supra* note 3, 496.

¹⁷ This is because merger control in the EU ultimately aims to protect the interest of customers. The attitude of the Commission to competitors of merging parties is clarified in the Guidelines on Non-horizontal Mergers: 'In the context of competition law, the concept of 'consumers' encompasses intermediate and ultimate consumers. When intermediate customers are actual or potential competitors of the parties to the merger, the Commission focuses on the effects of the merger on the customers to which the merged entity and those competitors are selling. Consequently, the fact that a merger affects competitors is not in itself a problem.' Paragraph 16, the Guidelines on Non-horizontal Mergers. On the adoption of welfare standard, there are ample discussions in the EU, although a large number of voices back up consumer welfare standards. AJ Padilla, *Efficiencies in horizontal mergers: Williamson revisited* in W D Collins, *Issues in Competition Law and Policy*, (American Bar Association Press, 2005), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=812989 (accessed on the 12th September 2013). Enterprise Directorate-General European Commission, For the customer's sake: The competitive effects of efficiencies in European merger control, (2002) *Enterprise Papers No. 11*, available at: <http://edz.bib.uni-mannheim0.de/www-edz/pdf/entpap/ep-11-2002.pdf> (accessed on the 10th December 2012); S Friodolfsson (Research Institute of Industrial Economics), A consumers' surplus defence in merger control, (2007) *IFN Working Paper No. 686*, available at: <http://www.ifn.se/Wfiles/wp/wp686.pdf> (accessed on the 1st January 2013); D J Neven and L Roller, Consumer Surplus vs. Welfare Standard in a Political Economy Model of Merger Control, (2005) Volume 23, *International Journal of Industrial Organization*, pp.829-848.

¹⁸ This point can also be found in PW Dobson and R Inderst, The Waterbed Effect: Where Buying and Selling Power Come Together, (2008) Volume 2, *Wisconsin Law Review*, 341.

2.1.3 The Role of Smaller Customers

Buyer power may be asymmetric between larger and smaller customers. In such markets powerful buyers may be able to protect their positions, but their negotiating power may not be able to shield weaker purchasers. The merging parties will price discriminate to big buyers and other medium/small purchasers.¹⁹

The Commission chooses to consider the positions of all, not just the larger customers. The Guidelines on Horizontal Mergers states: ‘countervailing buyer power cannot be found to sufficiently off-set potential adverse effects of a merger if it only ensures that a particular segment of customers, with particular bargaining strength, is shielded from significantly higher prices or deteriorated conditions after the merger’.²⁰ Therefore buyer power arguments have no relevance in markets where price discrimination is possible.²¹ The question is when price discrimination is more likely to arise and to be harmful to consumer welfare.

In order to answer this question the Commission considers the symmetry of market structures on the supply-side and retailer-side.²² Symmetry of buyer and supplier markets is a significant indication of the existence of buyer powers.²³ If

¹⁹As both the EU and China aim to protect ‘all’ sizes of customer, the vicious effect of price discrimination between customers will not be discussed in depth here. In general, discounts to a few large buyers can lead to a worsening of terms of supply for smaller buyers, thereby lessening retail competition. In the long run, as weaker competitors are excluded, dominant retailers can charge dominant price to consumers. They can also lower investment and the speed of innovation when there is less competitive pressure. The interest of consumers will then be harmed. See P Dobson and R Inderst, *ibid*, 393; R Inderst and TM Valletti, *Buyer Power and the ‘Waterbed Effect’*, (2011) *The Journal of Industrial Economics*, 59.

²⁰Paragraph 67, Guidelines on Horizontal Mergers.

²¹Case IV/M.190 *Nestle/Perrier*, [1992] O.J.L356/1, paragraph 78. See also Case COMP/M.2097 *SCA/Mesta Tissue*, paragraphs 85-91. In the above two cases the Commission accepted that some buyers might have a certain buying power. However, since the Commission cannot exclude the possibility that the merged entity applies different conditions of sale to weaker buyers or customers, the countervailing buyer power is not in the end accepted.

²²The market which merging parties belong to is in the upstream of the retailer market. Final customers are the downstream market of the retail market.

²³See D E Mills, *Buyer Power and Industry Structure*, (2010) Volume 36, Issue 3, *Review of Industrial Organization*, pp. 213-225. R Inderst and G Shaffer said, ‘a more balanced market structure may ensure that both upstream and downstream firms have sufficient incentives to invest and to stay in the market in the long run’. See R Inderst and G Shaffer, *Buyer Power in Merger Control*, (2008) *Issues on competition law and policy*, 22, available at: http://www.wiwi.unifrankfurt.de/profs/inderst/Competition_Policy/Articles%20and%20Book%20Chapters%20on%20applied%20Competition%20Economics/Buyer_power_in_merger_Control.pdf (access

concentration ratio on the supplier-side is higher than on the buyer side, each buyer's purchasing volume may only take parts of the sellers' total output. By contrast, customers may buy a very high proportion of their total products from a certain supplier. In this case buyers depend on suppliers more than the reverse.²⁴ However, higher concentration on the buyer-side may result in the economic dependence of suppliers on big buyers. Such dependence will result in vertical foreclosure between suppliers and buyers. Small customers will get discriminatory treatment unlike its strong competitors. If the small buyers are intermediate retailers, their exclusion will increase the market power of remaining retailers which are able to charge supra-competitive prices to final customers.²⁵ So far the Commission has only cleared one merger case based on countervailing buyer power in which the markets of suppliers and buyers are symmetrical.²⁶ In *Enso/Stora* the European Commission was concerned merged entity would discriminate between two buyers (Elopak, and SIG Combibloc) which bought much smaller volumes of liquid packaging board than the largest purchaser (Tetra Pak). In order to address the concerns Enso had offered to Elopak to divest its share in the joint venturing activities with Elopak. In addition, the merged entity offered a price protection mechanism to Elopak and SIG Combibloc which would ensure that the two smaller buyers would not be discriminated in comparison to Tetra Pak.²⁷

In conclusion, neither suppliers nor buyers can be price makers if their market structures are fragile. On the contrary, if there are only a few sellers and buyers in

ed on the 30th January 2013). By contrast, asymmetry of market shares between suppliers and buyers will lead to economic dependence. See the discussion in A Pera and V Bonfitto, Buyer power in anti-trust investigations: a review, *supra note* 3, 415.

²⁴The extent of dependence might be deeper if the suppliers have a 'must stock' brand or expertise. Although large supermarkets have buyer power to countervail its suppliers, the Commission is of the opinion that those supermarkets are still dependent on their suppliers because the products of suppliers are 'must stock' items. See Case No IV/M.1313 *Danish Crown/Vestjyske Slagterier*, [2000] O.J. L20/1, paragraph 173; case IV/M.833 *the Coca-Cola Company/Calsberg A/S* [1998] O.J. L154/41, paragraph 81.

²⁵Through the 'waterbed effect' or 'spiral effect' weaker buyers will be excluded by their competitors' embracing stronger power. See I Kokkoris, Buyer Power Assessment in Competition Law: A Boon or a Menace, *supra note* 3, pp.139-164.

²⁶In *Enso/Stora* merger would have resulted in one large and two smaller suppliers' were being faced with one large and two smaller buyers. Finally, the Commission considered that the buyers in these rather special market situations had sufficient countervailing buyer power to remove the possibility of the parties' exercising market power. See Case IV/M.1225 *Enso/Stora* [1999] O.J. L254/9, point 97.

²⁷Case COMP/M.1225 *Enso/Stora*, [1999] O.J. L 254/9, points 84-97.

the market, they might collude vertically to the detriment of consumers.²⁸ The Commission does not specify how much market share of buyers can be deemed to have countervailing buyer power.²⁹ The actual effect of countervailing buyer power should be analysed case by case. But it is necessary to show benefits to the final consumers.³⁰

2.2 Countervailing Buyer Power in China

Pursuant to Article 5 of the Interim Rules, in considering whether a merger will create or strengthen market power, the MOFCOM should assess the purchasing capacity of the downstream customers of the merging parties.³¹ This article indicates that the MOFCOM also involves countervailing buyer power in merger assessment. However, the MOFCOM does not establish an analytical framework within which the countervailing buyer power is assessed. The method of practice can only be reviewed in published decisions.

2.2.1 *The Existence of Viable Alternatives or Credible Threats*

The MOFCOM has not in published decisions accepted any successful countervailing buyer power. There are two possible reasons for such absence. On the one hand, successful tactics of buyer power were adopted by the MOFCOM, and the concentration was cleared outright without notice to the public. If the absence is for this reason, the MOFCOM should improve the transparency of its clearance

²⁸W A Adams, Competition, monopoly and countervailing power, (1953) Volume 67, *Quarterly Journal of Economics*, pp.469-492.

²⁹One opinion states 'the EU Commission and many NCAs consider that when retailers have a market share of 22 per cent or more in a certain category, suppliers of products in that category are in a state of economic dependence, because they cannot renounce to supply them. Shares between 10 and 20 per cent give a strong negotiating power to retailers, while below 10 per cent there would not be an asymmetric situation'. This criterion has not so far been adopted by the Commission. See A Pera and V Bonfitto, Buyer power in anti-trust investigations: a review, *supra* note 3, 415.

³⁰ PW Dobson and R Inderst, The Waterbed Effect: Where Buying and Selling Power Come Together, note 18, 341.

³¹The MOFCOM indicates that the entry of potential competitors might offset any anti-competitive effects caused by the transaction. See Article 5-(7) and Article 12, the Interim Rules.

decision, and give a more clear explanation of its considerations of buyer power.³² On the other hand, the MOFCOM did not find any buyer powers which were sufficient to restrain the price increase of the merged entity post-merger. Actually, in *General Motor/Delphi* the MOFCOM might ignore might have ignored the possibility of the existence of viable alternatives and buyer power. *General Motor/Delphi* was a vertical merger which was reviewed both in the EU and China. In the EU the Commission cleared this case outright, while input foreclosure and customer foreclosure were raised by the MOFCOM.³³ One reason for this inconsistency is that the MOFCOM did not investigate the buyer power of downstream competitors. The Commission ruled out the risk of input foreclosure as the presence of numerous alternative suppliers and a majority of customers stated that it would not be a problem for them to switch to alternative suppliers if the combined entity were to increase prices by 5-10%. In addition customer foreclosure was unlikely as GM's demand for the upstream products in the EEA only represented a limited fraction of total industry demand.³⁴ The MOFCOM raised input foreclosure without considering whether the downstream domestic manufacturers who relied on Delphi as sole supplier would be able to source from other suppliers when the new entity exercised its market power; regarding customer foreclosure the MOFCOM did not determine whether Delphi would have an incentive to refuse supply to other buyers except the acquiring firm (GM).³⁵ The MOFCOM cleared the case with behaviour conditions.³⁶ It raises the MOFCOM's cost on supervising the

³²A practical framework for analysis will be discussed in '2.3.1 Establishing an Analytical Framework' in this chapter.

³³ GM manufactures passenger cars and commercial vehicles, whereas Delphi produces a range of auto parts and components. The MOFCOM was concerned that, as Delphi is the sole supplier of a number of car manufacturers in China, the transaction could have an adverse effect on the stability, price and quality of Delphi's supplies to domestic car manufacturers. GM could increase its purchase of auto parts and components from Delphi, thereby potentially eliminating or restricting competition in the auto parts and components markets. The MOFCOM was also concerned that through Delphi GM could gain access to competitively sensitive information about its competitors. See Announcement MOFCOM [2009] No.76 *General Motors / Delphi*; Case COMP/M.5617 *General Motors/Delphi Corporation*[2010] O.J.C 9/1.

³⁴Case COMP/M.5617 *General Motors/Delphi Corporation*[2010] O.J.C 9/1, points 37 and 38.

³⁵L Ross and K Zhou, MOFCOM's Clearance of the Pfizer/Wyeth and GM/Delphi Transactions with Conditions, (October, 2009), available at:<http://www.wilmerhale.com/pages/publicationsandnewsdetail.aspx?NewsPubId=89400> (accessed on 27th September 2013).

³⁶The MOFCOM required after concentration that GM/Delphi must continue to supply domestic auto enterprises without discrimination; GM's procurement of auto parts was to continue to follow the

implementation of behaviour conditions post-merger while the anti-competitive concerns may have no basis.

2.2.2 The Incentive of Buyers to Act

The incentive of buyer power is considered in *Seagate/Samsung* and *Western Digital/Viviti Technologies*. According to historical evidence, the MOFCOM noted that

A price hike of HDDs was not opposed by large computer manufacturers if the increase was not to specific companies. Large computer manufacturers can pass the increase part of price onto final consumers through increasing the prices of computer products. Therefore the large computer producers have no incentive to exercise buyer power to countervail price increase in HDDs market.³⁷

In published decision the MOFCOM has not clarified in which scenario the intermediate buyers would have incentives to rebut the price increase of merging parties and pass its input saving onto final customers.

2.2.3 The Role of Smaller Customers

As with the EU the MOFCOM will not accept buyer power if a company is able to price-discriminate between big buyers and medium/small enterprises. In *Panasonic/Sanyo* the MOFCOM ascertained:

Although a portion of the large downstream customers has the buyer countervailing power to counterbalance the market power of the merged entity, such buyer countervailing power cannot extend to other

policies of multiple sourcing and non-discriminatory purchases. See section 7, Announcement MOFCOM [2009] No.76 *General Motors /Delphi*.

³⁷Part II-6, Announcement MOFCOM [2011] No.90 *Seagate/Samsung* and Announcement MOFCOM [2012] No.09 *Western Digital Ireland/Viviti Technologies*.

medium/small sized customers who do not have comparable bargaining power.³⁸

It is presumed that the MOFCOM believes small buyers would be harmed by the merger even if larger buyer firms were not. The protection of all customers may lead to a problem. When customers of merged entity are enterprises, which are not the final individual consumers, the harm of merger to the downstream entities might not cause harm to the downstream competition.³⁹ However, the reasoning proposed by the MOFCOM has sent a negative message to the business community in China: instead of striving to become more efficient competitors in the market, the domestic competitors could seek protection from the enforcement agencies.⁴⁰ Considering the MOFCOM's role in implementing non-competitive policy, the uncertainty will leave room for the intervention of non-competitive considerations, and rent-seeking activities such as lobbying.⁴¹

2.3 Discussion and Recommendations

2.3.1 Establishing an Analytical Framework

In China's legislation on antitrust merger control assessment, countervailing buyer power is still only a concept in legislation. No further practical rules can be found. This leaves great discretion to the MOFCOM. The buyer power defence in the EU is

³⁸Part IV-1-(c), Announcement MOFCOM [2009] No.82 *Panasonic/Sanyo*.

³⁹See the discussion in following '2.3.3 Situation of Price Discrimination'.

⁴⁰ The MOFCOM has missions to implement competition policy as well as industry policy. It has motive to deny the existence of countervailing buyer power and prohibit or impose substantial condition on notified foreign merger. Its excuse might be that small or medium domestic enterprises cannot countervail the market power of a merged entity. As the MOFCOM has incentive to protect domestic enterprises, in *Coca cola/ Huiyuan* competitors of the merged entity initiated the 'lobbying' activity to the MOFCOM. Many domestic juice enterprises jointly requested the MOFCOM to initiate a hearing regarding the concentration. They even sent these opposite views straight to the department which is at upper-level than the MOFCOM in the administrative system. This transaction was finally blocked. It does not know how much influence the domestic 'lobby' works in the procedure. See P Xie and Y Li, 可口可乐收购汇源被否的幕后博弈 [Backstage Game on prohibiting the acquisition of Huiyuan by Coca Cola, KekouKeleShougou Huiyuan Beifou de MuhouBoyij], (March, 2009), *南方周末* [Southern Weekly, Nanfang Zhoumo], available at: <http://www.infzm.com/content/26050> (accessed on the 20th February 2013).

⁴¹The role of the MOFCOM in conducting industry policy is described in '4.2.2.2 Mission of Implementing Non-competitive Considerations' in chapter 1.

assessed according to three factors discussed above. These are established in the Guidelines on Horizontal Mergers. The MOFCOM should consider including similar factors in published rules in future. The following section describes how to transfer the consideration factors from the EU to China.

First of all the MOFCOM should make clear that buyers of merging parties can restrain the price increase of a merged entity in three ways.⁴² Nevertheless, merging parties will exaggerate the effects of the buyer power in order to minimise the likelihood of anti-competitive effects of merger. The MOFCOM should especially care where buyer power is unlikely to switch supply when the merged entity's price increases, although available alternatives or potential entry exist. According to the experience of the EU, barriers deterring the shift of suppliers include customers' lack of enough information about other suppliers;⁴³ new suppliers' not having enough surplus capacity to satisfy the switch of order;⁴⁴ merging parties' own important product brands,⁴⁵ and the alternatives' in the market not being the close substitutes of merging parties' products. Secondly, if buyers intend to constrain the price increase of a merged entity through entering into the upstream market itself, they have to overcome various barriers or spend giant sunk cost. The MOFCOM should treat it as a potential entry in assessment.⁴⁶ Thirdly, buyer power does not need to be conducted before merger. A mere possibility of threat to conduct the above two scenarios is enough to prove the existence of buyer power defence. The MOFCOM could evaluate the effect of threats in the light of realistic entry.

⁴²These three situations are discussed in '2.1.1 The Existence of Viable Alternatives or Credible Threat' in this chapter.

⁴³ M L Steptoe, the Power-Buyer Defence in Merger Cases, *supra* note 3, 497.

⁴⁴As Steptoe analysed, 'sophisticated buyers may become less astute in the face of such complexities as products that use a wide variety of materials, require negotiated payments for intangible such as patent licenses, or involve accounting problems such as the production of co-products from a single manufacturing process.' Therefore, when the buyers use a wide variety of materials to manufacture their products, they will find it hard to tell when the sellers' prices are supra-competitive especially when the price increases gradually. In this case the buyers would not switch suppliers when merged entity increases price post-merger'. See ML Steptoe, the Power-Buyer Defence in Merger Cases, *supra* note 3, 496.

⁴⁵Buyers may find it hard to find alternatives for products with 'must stock' brand, like Coca Cola for retailers of carbonated beverage.

⁴⁶Discussion of market entry refers to part 3 in the chapter.

2.3.2 When Buyers Have Greater Incentive to Initiate Their Countervailing Power

The MOFCOM should be aware that the more potential benefit buyers can get, the greater incentive they have to initiate their countervailing power. If expenditure on the merging parties' product takes a substantial percentage of buyer's total input cost, the buyer will have incentive to constrain the price increase of merging parties. Secondly, the MOFCOM should investigate the fierce competition in the end-product market. It decides whether the intermediate retailer would like to save input costs or pass the price increase of input costs directly onto final customers. Thirdly, in order to protect itself against supply disruptions or to acquire a mix of products, buyers may prefer to keep multiple procurement rather than sponsoring a rival of merged parties through offering a long-term contract exclusively. This concern may deter buyers from switching or sponsoring a supplier exclusively.⁴⁷

2.3.3 Situation of Price Discrimination

The MOFCOM should note when the buyer power may only benefit strong customers, while small customers will suffer or be excluded.⁴⁸ Price discrimination may develop strong buyers at the expense of weaker rivals. The MOFCOM should

⁴⁷In *Seagate/Samsung* investigation showed that the merged entity would still keep its multi-sourcing policy post-merger on the merchant market rather than in-house supply of heads and media. The notifying party claimed that it currently does not have spare capacity immediately to internalise the whole of Samsung's demand. Case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3, paragraph 568,

⁴⁸ Suppliers grant preferential treatment to major than smaller buyers. This leads to two-fold advantages. Major buyers get more advantageous term for themselves. They can use the cost advantage to invest more in research and development in order to widen the gap between them and small buyers. Small buyers, in order to keep market share, are squeezed to cut prices to the same level as stronger buyers although the wholesale price is higher (the 'waterbed' effect). In the short term the price of products to customers could be reduced. However, when small buyers are squeezed sufficiently and leave the market, the supply-side market will be further consolidated. Strong buyers could reduce the depth or breadth of their previous offering to customers or reduce outside options for consumers. In this situation consumer welfare is harmed. See P W Dobson and R Inderst, *The Waterbed Effect: Where Buying and Selling Power Come Together*, *supra* note 18,337.

analyse buyer power and price discrimination based on a careful case-by-case analysis of ‘the interaction of horizontal and vertical effects’.⁴⁹

Firstly, if buyer power defence is initiated, the MOFCOM should investigate the market structures on the supply-side as well as the buyer-side. Price discrimination may arise if the markets of supply-side and buyer-side are both concentrated. Since horizontal merger raises anti-competitive concerns, the merged entity may take a single dominant position or collective dominant position with other competitors. The supply-side of the market is consolidated in a unique supplier or a number of competitors. If there are also dominant buyers on the downstream market, such strong buyers may negotiate terms of trade with merging parties that do not apply to small buyers. Such a price discrimination situation is more likely to happen in the market of the buyer-side if:

- 1) The wholesale price has a closer relationship with the purchase volume; especially where ‘there is already substantial price discrimination among buyers of different size’; 2) there is a considerable overlap between the outlets controlled by the stronger buyer and those of the rivals discriminated against. In such situation the growth of the buyer will be more at the expense of its weaker rivals rather than through expanding the market as a whole;⁵⁰ 3) price discrimination appears more easily in cases where some merging parties also possess substantial power (or where such market power is created through merger) in the downstream market. It will increase the wholesale price to the other rivals in the buyer side market.⁵¹

In light of the above the MOFCOM should investigate industrial practices and supply arrangement before concluding that price discrimination would take place in a specific case. If any of the above situations is detected in its investigations the MOFCOM should consider a possible consequence of price discrimination to the final consumers. Nevertheless, the MOFCOM should bear in mind that exclusion of

⁴⁹See ‘2.1.3 The Role of Smaller Customers’ in the chapter.

⁵⁰See Case IV/M.1221, *Rewe/Meinl*, [1999] O.J. L274/1.

⁵¹See P Dobson and R Inderst, *The Waterbed Effect: Where Buying and Selling Power Come Together*, *supra* note 18, pp.332-357.

fragile customers is not the only result. In order to countervail the market power of a merged entity, weaker buyers can enlarge its power through cooperation, such as 'a group purchasing organisation or even a buyer cartel'.⁵² In addition, some large buyers may also wish to resell products to small buyers in arbitrage transactions.⁵³ The MOFCOM could undo a transaction on the condition of price protection to smaller buyers. The price protection will guarantee that, subject to objective cost justifications, any percentage increase in the parties' prices to larger buyers will not be smaller than the percentage increase in the prices to smaller customers. Similarly, any percentage price decrease to larger buyers will not be greater than any percentage price decrease to smaller purchasers.⁵⁴

2.3.4 Publishing Reasoning Process

In the EU there is no definite situation in which buyer power exists and will be exercised after merger. Firstly, notwithstanding available alternatives or credible new entry are available, large buyers may not switch because of incomplete information, high switch cost or 'multiple source' strategy. Secondly, strong buyer power may not shield smaller buyers from the unilateral effects of an upstream merger. In the long run competition in the downstream market will still be affected. Therefore, in published decision, the MOFCOM should not just declare that 'buyer power is insufficient to countervail the power of the merged entity'.⁵⁵ In order to set a reference for further cases the MOFCOM should disclose arguments submitted by merging parties, and its comparative reasoning on each point.

⁵²See D E Mills, Buyer Power and Industry Structure, *supra* note 23, 3.

⁵³ See section III. Treatment of cases where some buyers are large and some are small in M L Steptoe, the Power-Buyer Defence in Merger Cases, *supra* note 3, 499.

⁵⁴Paragraph 78, Case IV/M.1882 Pirelli/BICC, points 78. See Case COMP/M.1225Enso/Stora, [1999] O.J. L 254/9, points 84-97. Imports make the supply of liquid packaging board more competitive. Case COMP/M.1225Enso/Stora, [1999] O.J. L 254/9, points 84-97.

⁵⁵Part 4-1-(3), Announcement MOFCOM [2009] No.82 *Panasonic / Sanyo*.

3 Entry

3.1 The Ease of Entry in the EU

Even when merger will create a dominant firm the Commission still believes it is compatible with market competition ‘if there exists strong evidence that this position is only temporary and would be quickly eroded because of high probability of strong market entry’.⁵⁶ It has various debates on the concept of entry barriers. The main argument concerns two distinct approaches to defining market entry. The first approach is proposed by Bain and the other is by Stigler.⁵⁷ Bain defines barriers to entry from the above-normal profits which incumbents can earn without inducing entry. Stigler analyses barriers to entry from cost advantage that entrants must bear but incumbents do not. The difference between these two concepts is treatment to scale economies and capital requirements. The former definition takes scale economies and capital requirements as barriers deterring entry, whereas the latter excludes these two considerations from barriers to entry as incumbents had to bear them as well in the past.⁵⁸ The following reviews the approach of the Commission to analysing market entry in merger control.

The concept of barriers to entry in the EU aligns more closely with Bain than with Stigler. Barriers to entry are defined as ‘specific features of the markets which give incumbent firms advantages over potential competitors’.⁵⁹ In determining whether entry is ‘easy’ the Commission indicates that they will explore whether ‘entry would be timely, likely, and sufficient.’⁶⁰

⁵⁶ See Case No IV/M.53 *Aerospatiale-Alenia/de Havilland*, [1991] O.J. L334/42, paragraph 53.

⁵⁷ Various definitions of market entry are concluded in R P McAfee *et al.*, What Is a Barrier to Entry?, (May 2004) Volume 94 No.2, *AEA Papers and Proceedings*, pp. 461-465. The differences between these two approaches has been analysed in Editors of ABA, *Market Power Handbook*, (ABA publishing, 2005), 123.

⁵⁸ Editors of ABA, *ibid.*

⁵⁹ Paragraph 70, Guidelines on Horizontal Mergers.

⁶⁰ For discussion of market entry see, D Besanko and D Dranove *etc.*, *Economics of Strategy*, Third Edition, (Wiley, 2003), pp. 297-326; R H Bork, *Antitrust Paradox: A Policy at War with Itself*, (the Free Press, 1980), pp. 310-330; D T Scheffinan and M Coleman, Quantitative Analyses of Potential Competitive Effects From a Merger, (2003) Volume 12 Issue 2, *George Mason Law Review*, pp. 319-

3.1.1 Likelihood of Entry

The Guidelines state that ‘potential entry is likely to constrain the behaviour of incumbents post-merger only if it is sufficiently profitable taking into account the price effects of injecting additional output into the market and the potential responses of the incumbents.’⁶¹ In the Guidelines on Horizontal Mergers the Commission divides the barriers to entry into four kinds which accord with the legal entry barriers proposed in the literature.⁶² These barriers are legal advantages and technical advantages (economies of scale) secured by incumbent firms, the established position of incumbent firms on the market, and sunk costs of entry. Manufacturers may give up accessing into a market if the costs of overcoming barriers to entry outweigh the benefit of the supra-competitive price after entry.

i. Legal advantage

The Commission takes legal advantages of incumbent firms to be situations ‘where regulatory barriers limit the number of market participants by, for example, restricting the number of licences. They also cover tariff and non-tariff trade barriers’.⁶³ Scholars remind enforcement authorities to pay attention to specific situations. For example, legal advantages of incumbents may not be obvious if the

370; D Harbord and T Hoehn, Barriers to Entry and Exit in European Competition policy, (1994) Volume 14, *International Review of Law and Economics*, pp. 411-435; N Attenborough *et al.*, Are three to two mergers in market with entry barriers necessarily problematic?, (2007) Volume 28 Issue 10, *E.C.L.R.*, pp. 539-552; M Leddy, Entry Issues in Merger Analysis, (1985) Volume 54, *Antitrust Law Journal*, pp. 1257-1985.

⁶¹ Paragraph 69, Guidelines on Horizontal Mergers.

⁶² ‘Legal entry barriers’ is a term used to distinguish these from entry barriers in economic theory. Under the economic theory of the Chicago school, some legal entry barriers are not taken to be obstacles from the economic perspective, like vertical issues. Although classification is varied, the content of entry barriers has no significant differences. See D Harbord and T Hoehn, Barriers to Entry and Exit in European Competition policy, *supra* note 60, 415.

⁶³ Paragraph 71, Guidelines on Horizontal Mergers. See also notes 88 and 89, citing Cases IV/M.1430 *Vodafone/Airtouch*, (1999) O.J.C295/02, paragraph 27; Case IV/M.2016 *France Télécom/Orange*, (2000) O.J.C261/06, paragraph 33.

licence fee is lower than the profits after entry or patents can be avoided by redesigning products or processes easily.⁶⁴

ii. Technical advantages

The Commission outlines a series of technical advantages enjoyed by the incumbents which make it difficult for any entrant to compete successfully.⁶⁵ The most controversial point among these advantages is economies of scale and scope secured by incumbents.⁶⁶ In the Guidelines on Horizontal Mergers the effect of economies of scale and scope in easing entry is not illustrated. In general, economies of scale may result in a high ‘minimum viable scale of entry’ and a high ‘minimum efficient scale’.⁶⁷ It makes market entry through two channels unprofitable. The first is to spend more money on investment; the second is to have less chance to recoup investment as the increase of output post-merger would result in the reduction of product price even below the pre-merger level.⁶⁸ On the other hand, there are voices denying economies of scale are a barrier to entry in any instance because firstly the cost entrants pay for economies of scale is also paid by the previous incumbents.⁶⁹ Secondly the cost savings brought by economies of scale may outweigh its detriment to the interest of consumers.⁷⁰ Thirdly scholars believe the cost of scale economies can be recouped

⁶⁴Editors of ABA, *Market Power Handbook*, supra note 57, 130.

⁶⁵Point 71, Guidelines on Horizontal Mergers.

⁶⁶See Chapter 2 in J Stennek and F Verboven, Merger control and enterprise competitiveness-empirical analysis and policy recommendations in F Ilzkovitz and R Meiklejohn, *European Merger Control: Do We Need an Efficiency Defence?*, (Edward Elgar Publishing Ltd, 2006), pp.202-302; J Farrell and C Shapiro, Scale Economies and Synergies in Horizontal Merger Analysis, (2001) Volume 68 No.3, *Antitrust Law Journal*, pp. 685-710.

⁶⁷The minimum viable scale refers to the smallest annual level of sales that the committed entrant must persistently achieve for profitability at pre-merger prices. The minimum efficient scale (MES) refers to the output level at which the unit costs stop falling as output increases. See note 421, Editors of ABA, *Market Power Handbook*, supra note 57, 128. Citing the concepts from note 29 in the US Horizontal Merger Guidelines, 1992 (amended in 1997), s.3.3.

⁶⁸These two effects have been pointed out in Editors of ABA, *ibid.*, 128.

⁶⁹This is the opinion of Stigler on the assessment of market entry.

⁷⁰Economies of scale are a vital part of efficiency created by merger. The cost savings brought by economies of scale may be more than the compensation for reduction in total output because of fewer firms post-merger. In this situation economies of scale as a barrier to entry are not detrimental to the interest of consumers. Efficiency defence involving economies of scale created by merger will not be discussed in this thesis.

if a fraction of consumers can switch from the incumbents to new entrants or total output is increased due to market growth.⁷¹ To sum up, economies of scale can only be taken as barriers to entry when associated with substantial sunk costs which are uncertain to be recovered after merger.⁷² The EU embraces a cautious altitude to economies of scale. It was identified as a barrier to entry in many cases unless ‘the entrant can obtain a sufficiently large market share’.⁷³ For example, in *Sanitec/Sphinx*, the Commission stated that barriers to entry in the European bathroom product market are high. One reason is that:

High capacity utilisation is generally necessary for the production of bathroom products to be profitable and thus it must be assumed that a new market entrant would be required to sell a considerable volume of output.⁷⁴

iii. The established position of the incumbent firms on the market

Incumbents often have a ‘first mover’ advantages because they have already built a quality or brand name reputation. New entrants may have to work harder and spend more on promotion or advertising in order to break ‘consumer loyalty to a particular brand and the closeness of relationships between suppliers and customers.’⁷⁵ In addition, if incumbents still have excessive capacity, they may expand their output by excessive capacity with lower costs in the short term to deter the new entrant. Its advantage in expansion raises a barrier to entry.

iv. Sunk costs of entry

Sunk costs are those which are irrecoverable upon exit from the market.⁷⁶ Their impact has three aspects. To new entrants sunk costs increase the risk of entry

⁷¹Hence the Commission indicates that ‘entry is more likely to be profitable in a market that is expected to experience high growth in the future than in a market that is mature or expected to decline’. See paragraph 73, Guidelines on Horizontal Mergers.

⁷²This point is also expressed in H M Mialon and M A Williams, What Is a Barrier to Entry?, (2004) Volume 94 No.2, *AEA Papers and Proceedings*, 423.

⁷³Paragraph 72, Guidelines on Horizontal Mergers.

⁷⁴Case IV/M.1578 *Sanitec/Sphinx*, [2000] O.J. L 294/1, point 114.

⁷⁵Paragraph 71-c), note 94 and 95, Guidelines on Horizontal Mergers.

⁷⁶Note 41, Guidelines on Horizontal Mergers.

because they cannot be recouped on exiting; to incumbents, it is a commitment to stay in the market, and they will think up a number of strategies to deter the entry of other entrants; sunk costs create a cost asymmetry between entrants and incumbents.⁷⁷ Therefore the Commission recognised that high risk and costs of failed entry may make entry less likely,⁷⁸ unless an entrant must be sure that it will recoup its sunk costs through its sales.⁷⁹ Therefore entry is particularly likely if suppliers in other markets already possess production facilities that could be used to enter the market in question, thus reducing the sunk cost of entry,⁸⁰ or investment for market entry can be protected by commitments. By contrast, entry is less likely if the expected output post-entry is not large relative to the size of the market, as large sunk costs may not be distributed across a limited volume of sales.⁸¹

3.1.2 Timeliness

The Commission examines whether entry would be sufficiently swift and sustained to deter or defeat the exercise of market power. The entry is normally only considered timely if it occurs within two years. However, the acceptable period can be adjusted according to ‘the characteristics and dynamics of the market, as well as on the specific capabilities of potential entrants’.⁸² For instance, the period of market entry can be prolonged if ‘goods and services are supplied and purchased on long-term contracts’ or ‘the relevant product is a durable good’.⁸³

⁷⁷Kinds of sunk cost and the influence of sunk cost on market entry have been analysed in D Harbord and T Hoehn, *Barriers to Entry and Exit in European Competition policy*, *supra* note 60, 414. See also BC Eaton and R GLipsey, *Exit Barriers are Entry Barriers: The Durability of Capital as a Barrier to Entry*, (1980) Volume 11, No. 2, *The Bell Journal of Economics*, pp.721-729.

⁷⁸Paragraph 69, Guidelines on Horizontal Mergers.

⁷⁹ Editors of ABA, *Market power hand book*, *supra* note 57, 127.

⁸⁰Paragraph 73, Guidelines on Horizontal Mergers.

⁸¹ Editors of ABA, *Market power hand book*, *supra* note 57, 129.

⁸²Paragraph 74, Guidelines on Horizontal Mergers. The Commission only states that a five- year period post-merger is ‘clearly outside the time frame used to assess the impact of potential competition on a proposed merger’. See Case No COMP/M.1693 *Alcoa / Reynolds*, O.J. L 58/25, point 31.

⁸³See chapter 5, ICN Merger Working Group: Analytical Framework Subgroup, Project on Merger Guidelines: Report for the Third ICN Annual Conference in Seoul (April, 2004), point 37, note 75 and

3.1.3 Sufficiency

The Guidelines on Horizontal Mergers states: ‘entry must be of sufficient scope and magnitude to deter or defeat the anti-competitive effects of the merger’.⁸⁴ The meaning of sufficiency is obvious. Small entry in scope and magnitude still cannot restrict the merged entity with high market share to behave independently of its competitors following the concentration. In *Tetra Pak/Alfa Laval*, although the Commission had identified at least one potential entrant, market of entry was still not considered to be significant enough to limit Tetra Pak’s freedom of action. An entrant is required to get patents, have track records and invest heavily, which might exceed returns. Therefore the Commission still believed the barriers to entry were high.⁸⁵

However, in the Guidelines the Commission does not further define the criteria for the extent of ‘scope and magnitude’ which can be seen as sufficient. In general, the output of new entrant should be large enough to fill the gap between the likely output in the absences of the merger and the likely post-merger output.⁸⁶

3.1.3.1 Historical Evidence on Entry

The Guidelines on Horizontal Mergers indicate that historical examples of entry and exit in the industry may provide useful information about the size of entry barriers.⁸⁷ In general, historical entry may imply the future condition if the market situation shows little change. If market situation changes historical evidence may not indicate the future entry properly. One condition is that historical entry may

76. Capabilities of market entry can only be checked when long-term contracts are terminated or the durable goods need to be changed after being used for a period of time.

⁸⁴Paragraph 75, Guidelines on Horizontal Mergers.

⁸⁵ Note 101, Guidelines on Horizontal Mergers. Citing Case IV/M.68 *Tetra Pak/Alfa Laval*, [1991]O.J. L 290/35, point 3.4.

⁸⁶Note 38 in Lindsay, *The EC Merger Regulation: Substantive Issues*,supranote11, 486. The reason has been explained in US Horizontal Merger Guidelines, 1992, s3.4. ‘As merged entity will increase the price post-merger, its sales will be reduced. Entry will make the merged firm be unable to internalize enough of the sales loss due to the price rise, rendering the price increase unprofitable’.

⁸⁷Paragraph 70, Guidelines on Horizontal Mergers.

not imply that future entry is easy or likely;⁸⁸ on the other hand, recent changes in the market may make market entry easier than before.⁸⁹ In conclusion, no single item of evidence can make sure that entry will be likely, timely or successful. Rather, analysis must consider a wide range of evidence.⁹⁰

3.2 Ease of Entry in China

As with the EU the Interim Rules in China also make clear that MOFCOM will review the ‘likelihood’, ‘timeliness’ and ‘sufficiency’ of proposed entry.⁹¹ However, the Assessment Rules provide no guidance on the meaning of these three terms.⁹² It is unknown whether there is any new entrant that was considered sufficient to counteract the anti-competitive issue of merger in China. Once a merger is cleared because of countervailing entry power, the decision will not be published by the MOFCOM.⁹³ Thus, in merger case analysis following, it can only be known in which condition entry is not able to countervail anti-competitive concerns caused by the concentration. It is opaque on the standard of a successful market entry.

3.2.1 Likelihood of Entry

In practice the MOFCOM considered the technical requirements leading to high sunk cost of entry, such as natural resources,⁹⁴ innovation and R&D,⁹⁵ intellectual

⁸⁸ The market power handbook also lists four such conditions: 1) the structural characteristics of the market were substantially different currently; 2) the previous entrant has entered with large scale which makes up the gap between capacity and demand in the market. For the current entrant large scale of entry will lead to excessive capacity and unprofitability; 3) previous entrants have some rare resources for entry which the new entrant cannot get, or 4) where the legal/regulatory environment has been stricter to new entrants currently. Editors of ABA, *Market power hand book*, *supra* note 57,127.

⁸⁹ The market power handbook also described such a scenario, ‘the expiration of a patent, sudden growth in demand or changes in regulation all can work to facilitate entry’. Editors of ABA, *ibid.*, 138.

⁹⁰ *Ibid.*, 139.

⁹¹ See also Article 7 and Article 12 of the Interim Rules, ‘if barriers deterring accessing into the relevant market of merging parties are low, business operators who do not participate in the concentration are able to restrain merging parties to eliminate or restrict competition post-merger’.

⁹² No secondary literature can be found on the topic.

⁹³ According to article 28 of the AML2008 only clearance with restrictive conditions and prohibition need to be published.

⁹⁴ In *Uralkali/Silvinit*, barrier to entry to the relevant market is considered to be high, since ‘after the review, the MOFCOM found that potassium resources are mainly concentrated in the existing

property rights,⁹⁶ the cost that customers confronted in switching to a new supplier.⁹⁷ In addition, economies of scale may also constitute barriers to entry.⁹⁸ Apart from sunk costs, barriers to entry considered by the MOFCOM also included the expected evolution of the market⁹⁹ and historical examples of entry and exit in the industry.¹⁰⁰

potassium chloride manufacturers, because the exploitation of new mines or expansion of existing facilities require massive funds, which are time-consuming and involve significant risks in terms of industry, technology, geology and environment. Hence, it is relatively difficult for other competitors to enter the potassium chloride market'. Section 2, paragraph 5, Announcement of MOFCOM [2011] No.33, *Uralkali / Silvinit*.

⁹⁵In *Pfizer/Wyeth*, the MOFCOM indicated that 'R&D of drug needs high cost and a long period. According to statistics, to develop a new product takes about three to ten years with the investment of 2.5 million to 10 million U.S. dollars. Market investigation indicated that technical barriers for entering into MPS market are even higher. After Pfizer's acquisition of Wyeth, Pfizer is very likely to use the scale advantage to further expand its market in China, to suppress other competitors and compress market space of other enterprises.' Section 4, 2)-3, Announcement of MOFCOM [2009] No.77, *Pfizer/Wyeth*. In case *GE/Shenhua* the investigation revealed that the coal-water slurry gasification technology is a complex of many sophisticated technologies, and the process and engineering technologies involved could only become mature after a long period of practice, and there are significant commercial risks for new technologies that have not been sufficiently tested. Section 2-paragraph 6, Announcement MOFCOM [2011] No.74 *GE/Shenhua*.

⁹⁶In *Savio / Penelope*, investigation found that the relevant patents, know-how and trade secrets play a key role in the research, development and production of electronic yarn clearers for automatic winders, and the relevant technologies are protected by patents and other intellectual property rights, which is a significant barrier or new entrants. Section 2-4), Announcement MOFCOM [2011] No.73 *Savio / Penelope*.

⁹⁷In *Google/Motorola Mobility* the MOFCOM indicated that the barriers to entry to the market of operating systems for smart mobile phones are high. One of the reasons is the high switching cost to customers. See part two, point 7, Announcement MOFCOM [2012] No.25 *Google/Motorola Mobility*.

⁹⁸In *Savio/Penelope* economies of scale were quite important in the industry of textile machinery including electronic yarn clearers, and it was very difficult for new entrants to establish economies of scale in a short time. Section 2-4), Announcement MOFCOM [2011] No.73 *Savio / Penelope*. In *Samsung/Seagate* the MOFCOM investigated the importance of economies of scale in the relevant market. New entrants could not survive unless their manufacture and sales reached a certain amount. In order to realise the economies of scale, new entrants should invest significantly in production, R&D and marketing which has high risk in the process. Section 2-7), Announcement MOFCOM [2011] No.90 *Seagate / Samsung*.

⁹⁹ In *Panasonic/Sanyo* the MOFCOM found that the development of Nickel Hydrogen Battery market had slowed down and therefore it was fairly difficult to attract sufficient market entrants to offset the restrictive and eliminative competitive effect. Section IV-2-c), Announcement MOFCOM [2009] No.82 *Panasonic / Sanyo*.

¹⁰⁰ In *Savio/Penelope* investigation did not find any successful case of new entry into this market during the past three years. Evidence showed that there were companies collaborating in research and development in electronic yarn clearers for automatic winders in 2009, but their product did not receive customer recognition, and did not win any market share in 2010. MOFCOM concluded that there were considerable difficulties for new entry into the market of automatic yarn clearers for automatic winders. Section 2-7), Announcement MOFCOM [2011] No.73 *Savio / Penelope*. In *Seagate/Samsung* the MOFCOM found that 'in the latest decade, there is no new entrant access to the market'. Section 2-4), Announcement MOFCOM [2011] No.90 *Seagate / Samsung*.

Unlike in the EU legal advantages of incumbent firms have not appeared in the MOFCOM's published decisions to date. These include the limited number of licences, tariff and non-tariff trade barriers.

3.2.2 Timeliness

By June 2013 the MOFCOM still had not given a clear response to the question how they would react to the expected entry post-merger. According to the rules of the MOFCOM merger investigation is based on the statistics of the year before notification.¹⁰¹ *Mitsubishi Rayon/Lucite* was notified on 22 December 2008. Therefore the MOFCOM was supposed to investigate the statistics of market situation in 2007. However, the MOFCOM neither mentioned the market entry in 2007, nor expected the effects of a potential entrant on market competition in the year following merger.¹⁰²

3.2.3 Sufficiency

To date the MOFCOM has not indicated the meaning of 'sufficiency' in its regulation or published decisions. Market entry has become a necessary condition to evaluating the likely effects of concentration on market competition in China. The case decisions of the MOFCOM show a cautious attitude towards allowing potential competition as a countervailing of anti-competitive concern.

¹⁰¹Pursuant to Article 4 of the Guidance for notification of concentrations of undertakings, 'the turnover of notification shall comprise the amount of the revenue received by the undertakings concerned in the preceding fiscal year from product sale and service provision, after the exclusion of relevant taxes and surcharges'. Ministry of Commerce of the People's Republic of China, Announcement No.11 of 1th January 2010, Measures for Notification of Concentrations of Business Operators (the 'Notification Measures').

¹⁰²See the case analysis in '3.3.3 Sufficiency of Market Entry' in this chapter.

3.3 Discussion and Recommendations

3.3.1 When Entry is more likely

Up to June 2013, eleven notified concentrations getting published case decisions in China were also reviewed in the EU. Except *Pfizer/Wyeth*, the barriers to entry in other transactions were considered high both in the EU and China.¹⁰³ It can be said that the threshold to market entry in China is not lower than in the EU.¹⁰⁴ In order to avoid the standard's being too cautious in China, certain recommendations are listed.

First of all the MOFCOM needs to draw up a check-list of entry barriers in related rules. This is to clarify the discretion of the MOFCOM, and give notifying parties a basis for argument. According to the experience of the EU the barriers to market entry include at least legal advantages, technical advantages of the incumbents, 'first-mover' advantages of incumbents and the expected evolution of the market.¹⁰⁵ As legal advantages are straightforward and obvious, their use needs no further discussion here. The following evaluates another three factors.

1. Economies of scale are not a reason for deterring market entry at any time, because market entry is still likely even where economies of scale are required. It depends on the scale of sunk costs, and whether such costs will certainly be compensated for post-merger.¹⁰⁶ On the other hand, economies of scale enjoyed by the merged entity might not be a barrier to entry either. For example, if a

¹⁰³In *Pfizer/Wyeth* the MOFCOM stated that the barriers to entry are high. However, the Commission concluded that pipeline products were expected to enter the market. It is one of the reasons for concluding that merger does not raise serious doubts in any MRCC market. See Case COMP/M.5476 *Pfizer/Wyeth* [2009] O.J. C 262/1, paragraph 38.

¹⁰⁴Indeed, from analysis in *Mitsubishi Rayon/Lucite* it is presumed that the MOFCOM has a higher threshold on the likelihood of market entry than the EU. See '3.3.3 Sufficiency of Market Entry' in the chapter.

¹⁰⁵See the discussion in '2.1.1 The Existence of Viable Alternatives or Credible Threats' in this chapter.

¹⁰⁶Sunk cost might be low if the new entrant is in the neighbouring relevant market. In addition, a new entrant will still enter a market if sunk cost is likely to be compensated through its sale. Microsoft's entering the internet browser business is an instance of the entrant's overcoming sunk cost and accessing the market as the size is larger than the largest incumbent. Thus it is presumed that sunk cost itself is not a barrier to entry. It is only a concern to the new entrant when it is associated with uncertain result. See R P McAfee *et al.*, What Is a Barrier to Entry?, *supra* note 57, 464.

substantial output is a requirement for profitability, then a small switch of customers may make it unprofitable;¹⁰⁷ or the market is in the growth. Therefore the MOFCOM should investigate the expected evolution of the market.

2. The established position of the incumbent may be temporarily and easily broken. Patents are not a barrier if they can be avoided by redesigning at low cost.¹⁰⁸ Technical advantage can be broken if R&D is fast. For example, in the pharmacy market pipeline products will enter the market when they are ripe.¹⁰⁹ Therefore the MOFCOM should also investigate the speed of evolution in assessing market entry.

3.3.2 Timeliness

Market entry within a certain period after merger should be considered. The specific time range is expected to be issued by the MOFCOM. However, the specific range should be adjusted in light of certain characteristics and dynamics of the market, such as the 'long-term contract of supply' or 'the duration of products'.¹¹⁰

3.3.3 Sufficiency of Market Entry

Given entry is likely, the next step is to consider whether the size of potential entrant is sufficient to restrict the merged group's behaving unilaterally. Up to now the MOFCOM has not identified any potential entrant in published decisions.

Its criteria in evaluating sufficiency can only be detected in *Mitsubishi Rayon/Lucite*.¹¹¹ On 12 December 2008, the MOFCOM received the notification of the proposed transaction. Later, Mitsubishi submitted supplementary documents according to MOFCOM's requirements. On 20 January 2009, the MOFCOM thought the filing documents met the standards and initiated merger review. After

¹⁰⁷See *supra* note 9.

¹⁰⁸See *supra* note 64.

¹⁰⁹See case analysis about *Pfizer/Wyeth* in *supra* note 96.

¹¹⁰See above note 84 in '3.1.2 Timeliness.

¹¹¹Announcement MOFCOM [2009] No.28 *Mitsubishi Rayon / Lucite*.

investigation, the MOFCOM concerned the notified concentration was very likely to impose adverse effects on China's MMA market. The market share of merged entity would reach 64% which would be much higher than Jilin Petrochemical Co., Ltd. and Heilongjiang Longxin Company, who were the second and the third largest players in the market. Therefore, the merged entity with dominant position would exclude and restrict competitors after concentration.

Actually, in 2007, the capability of MMA in Chinese market was 290,000 tons within which the capacity of Mitsubishi Rayon in China was 90,000 tons and the capacity of Lucite in China was 100,000 tons. The combined market share of merging parties was about 65.5% in 2007 which was close to 64% clarified by the MOFCOM in case decision. However, market structure had substantive changes in 2008. There exists strong evidence that this position of merged entity was only temporary and would be quickly eroded because of high probability of strong market entry. Firstly, Sinopec of Jilin Chemical Industry expanded its output to 100,000 tons, so the total capability of MMA in Chinese market increased to 340,000 tons in 2008. The capacity of merged entity would be 190,000 tons which took 55.9% share in Chinese MMA market. In 2009, Evonik (Shanghai) would conduct a project producing 115,000 tons of MMA per year. Thus, the share of merged entity in Chinese MMA market would be less than 40%. In addition, based on the Zero-Tariff policy between the Association of Southeast Asian Nations and China, MMA producers in Southeast Asia (e.g. the MMA manufacturers in Thailand and Korea) would easily access into China if the merged entity initiated its market power unilaterally. In light of the above, the transaction would not raise anti-competitive concerns on market competition.¹¹²The MOFCOM finally ignored those expected market entry in the published case decision which raised the criticism of specifically protecting domestic enterprises in merger control.¹¹³

¹¹²See B Wang and K Yan, Dispute on Market Share—Follow-up on *Mitsubishi v. Rayon*, (1st May 2009), *The Economic Observer*, 6, available at: <http://epaper.eeo.com.cn/pdf/pdf/eeo/418/06.pdf> (accessed on the 22nd February 2013)

¹¹³Domestic enterprises reported their concerns to transaction *Mitsubishi Rayon/Lucite* to State Council which has superior administrative authority than the MOFCOM. They argued that the transaction would further reduce the market power of domestic enterprises in competition, and create a monopoly. One opinion said the lobby from domestic enterprises and related trade association made great impact on case review. In addition, the MOFCOM did not organise a hearing in which

It is presumed that the MOFCOM still adopts an over-cautious altitude to proposed entry. When market entrant is likely and sufficient the MOFCOM can approve a transaction given countervailing market entry.¹¹⁴ No matter whether the defence of market entry is accepted or denied, the MOFCOM should present its reasons in published decisions.

merging parties could defend their views before domestic enterprises and industrial associations face to face. Merging parties and their rivals expressed their views to the MOFCOM separately. The merging parties were not entitled adequately to answer the anti-competitive concerns of their domestic rivals. In addition, the MOFCOM expressed its favour of protection of domestic enterprises in other cases. In *Uralkali / Silvini* the MOFCOM stated the importance of agricultural fertiliser to China's economy and food production stability. In remedies the MOFCOM requires the merged entity to maintain the *status quo* to customers in China. In order to prevent the 'political lobbying' from influencing its final decision, the MOFCOM should go a step further which not only clarifies the harm of proposed merger to domestic enterprises, but also to the market competition in case decisions. See B Wang and K Yan, *ibid*.

¹¹⁴ See note 87 *supra*. The product of a new entrant should also be a close substitute for the merged group's products in quality, duration and other essential respects.

Chapter 6: Conclusion

1 Key Findings in the Study

The development of an anti-trust merger control regime in China has been fast. More progress is expected with accumulation of merger review experience.¹ However, at present the horizontal merger analysis in the EU is better able to predict the effects of mergers on the competitive process. The EU also shows greater public transparency in merger assessment.² A number of shortcomings have been found in the Chinese system which deters merger assessment from properly evaluating the effects of mergers on the competitive process. These shortcomings have been identified following examination of four aspects of merger assessment, namely defining the ‘relevant market’, evaluating the unilateral effects of horizontal mergers, evaluating the coordinated effects of horizontal mergers, and evaluating the countervailing effects on anti-competitive concerns arising in relation to horizontal merger. Recommendations for avoiding these shortcomings in assessment are made here.

¹ The progress of antitrust merger control in China witnessed between 2008 and 2013 is discussed by, S Ning et al., Review of Merger Control and Merger Remedies Regime in China: From 2008-2013, (August, 2013), available at: <http://www.chinalawinsight.com/2013/08/articles/corporate/antitrust-competition/review-of-merger-control-and-merger-remedies-regime-in-china-from-2008-2013/> (accessed on the 12th November 2013); The Mayer Brown Practices, China Merger Control--Progress and Prognostications, (Spring/Summer, 2012), available at: <http://www.mayerbrown.com/China-Merger-ControlProgress-and-Prognostications-05-01-2012/> (accessed on the 12th November 2013); Q Wu, China's merger regulation: in search of theories of harm, (2013) Volume 34 Issue 12, *E.C.L.R.*, pp.634-641.

² Although the outcome of merger assessment of the same transaction was the same in the EU and China, it is hard to draw a line of reasoning for merger decisions in China. A similar opinion also expressed in M Furse, Merger control in China: four and a half years of practice and enforcement - a critical analysis, (2013) Volume 36 Issue 2, *World Competition*, pp.285-313.

1.1 Improvements to Horizontal Merger Analysis in China rendering it Better Able to Predict the Effects of a Merger on the Competitive Process

1.1.1 *The Definition of Relevant Market*

Both the EU and China define the relevant market from two aspects, namely the relevant product market and the relevant geographic market.³ However, unlike the EU, the MOFCOM has here made some mistakes in practice.

First of all the MOFCOM defines the overlap of merging parties' products as the scope of relevant product market.⁴ It neglects to assess whether customers could shift to purchase *other* substitutes when the price of overlap products increases. This neglect may lead to a narrower product market than the real situation indicates, and result in a mistaken condemnatory merger decision.⁵

Second, the MOFCOM still relies on some 'intuitive' factors in delineating a relevant market. These factors include product features, intended use and unique function of related industry.⁶ However, the experience of the EU has shown that products with a similar function may not be substituted because of consumer behaviour or brand loyalty. By contrast, products having different functions may still be taken as close substitutes by customers.⁷ More factors should be taken into account by the MOFCOM in defining 'relevant market'.

³ Although the EU proposed the third source of competitive constraint, namely potential competition, its analysis is only carried out at a subsequent stage if required. Hence the evaluation of potential competition is not carried out in chapter 2. See paragraph 24, Commission Notice on the definition of relevant market for the purposes of Community competition law[1997] O.J. C372/5.

⁴ See Announcement MOFCOM [2009] No.28 *Mitsubishi Rayon / Lucite*; Announcement of MOFCOM [2009] No.77, *Pfizer / Wyeth*.

⁵ See '4.2 The Scope of Possible Substitute' in chapter 2.

⁶ See *supra* note 117 in chapter 2.

⁷ See the discussion of physical characteristics of the product/services and intended use in point b in 2.1.1 Demand-side substitution in chapter 2.

Thirdly, as under the EU regime, demand-side substitution is primarily considered by the MOFCOM in defining the scope of relevant product market. Supply-side substitution is considered when it is ‘necessary’. The ‘necessary’ condition has no further clarification.⁸ Neglect of supply-side substitution may result in a narrower ‘relevant market’ than the real situation indicates. Competitive assessment based on a narrower relevant market may lead to false negative errors.

Fourthly, the scope of geographic market has not been defined in every published case in China. In many cases geographic market was delineated as nation-wide without giving any reasons. False positive errors may result if anti-competitive concerns exist in a specific narrower area of China. On the other hand, false negative errors will be caused if the geographic market is broader than China because the available imports may be substituted for local products.

Recommendations are proposed for the MOFCOM to define a more appropriate scope of relevant market. Firstly, the MOFCOM should give a general introduction about affected products, including their composition and how to classify them according to size, use or raw materials. The information on the relevant industry can be collected from notifying parties or by consulting related experts or organisations.⁹ The MOFCOM should analyse the substitution among products which are on the same level with the affected products.¹⁰ This would help to ensure that likely alternatives to the affected products can all be included in the substitutive test. Affected products might also have sub-categories. A substitutive test should

⁸ In fact, in certain published cases, there are many disputes on the scope of products which can be substituted for each other from the supply-side. In *Coca cola/Huiyuan*, from the standpoint of supply-side substitution, milk beverages might have belonged to the relevant product market with juice drinks. The possibility was declined by the MOFCOM without giving any illustration in its decision. See ‘4.2 The Scope of Possible Substitute’ in chapter 2.

⁹ Notifying parties are required to describe the business relationship between merging parties and define the relevant markets, providing reasons. See section 7 of MOFCOM’s amended merger notification form (Second version). An unofficial English translation of this form is available in the Appendix.

¹⁰ Information on the structure of related products can be collected by consulting related industry associations or international organisations. For example, in case *Novartis / Alcon* the Commission refers to the ‘Anatomical Therapeutic Chemical) classification (‘ATC), devised by the European Pharmaceutical Market Research Association (‘EpMRA’) and maintained by Eph MRA and Intercontinental medical Statistics (‘IMS’). See case COMP/M.5778 *Novartis / Alcon* [2011] O.J. C20/8.

be applied in these sub-categories in order to determine whether the affected product market should be further divided.

The second suggestion to the MOFCOM is to clarify when it is ‘necessary’ to consider supply-side substitution in defining ‘relevant market’.¹¹ According to the experience of the EU, such ‘necessary’ condition involves considering whether the supply-side substitution is as effective and immediate as demand-side substitution, especially when companies market a wide range of qualities or grades of one product.¹² In addition, as the MOFCOM still relies heavily on market shares to evaluate competitive effect, supply-side consideration is better considered at the ‘relevant market’ stage. Especially when demand substitution is weak or low, competitive concerns arise because the loss of sales may not be enough to countervail the profit of the merged entity’s price increase.

1.1.2 Horizontal Mergers--Unilateral Effects

The MOFCOM’s shortcomings in assessing unilateral effects have been stated in chapter 3.¹³

The first problem is that the MOFCOM relies too much on market share to define the anti-competitive effects of a merger.¹⁴ High market shares of merging parties have no anti-competitive effects if there are competitive constraints from competitors, buyers or final consumers.¹⁵ If competitors are not the closest competitors combined high market share will exaggerate their effects on market competition.¹⁶ On the other hand, a small market share of merged entities post-

¹¹ See Article 7, the Guideline on the Definition of Relevant Market. The Guideline was promulgated by the Anti-monopoly Committee of the State council on the 24th May 2009 and took effect on the same day (hereinafter called ‘the Guideline on Relevant Market’). An unofficial English translation is available at: http://www.cuplge.com/info_show.asp?news_id=30705 (accessed on the 23rd January 2012). The official translation is not issued in this thesis.

¹² Paragraph 20, Commission Notice on the definition of relevant market for the purposes of Community competition law (hereinafter Notice on Market Definition) [1997] O.J. C372/5.

¹³ See Chapter 3 Horizontal Mergers – Unilateral Effects, pp. 32-33.

¹⁴ See ‘3.1 Initial Review of Market Shares and Concentration Ratio’ in chapter 3.

¹⁵ A market leader which holds a large market share is not dominant in the market. These conditions can be seen in note 14 in chapter 3.

¹⁶ See ‘2.2 Merging Firms Are Close Competitors’ in chapter 3.

merger does not mean those mergers are compatible with the competitive process.¹⁷ Some firms have greater influence on the competitive process than their market shares indicate, particularly if the merged entity is coordinating with other rivals, innovating, expanding, cutting prices or generally independent as compared with the rest of the market. False positive errors might result if the MOFCOM does not consider these firms' influences in other aspects of competition.

Secondly, the MOFCOM takes the advantage of merging parties in distribution as detrimental to competitive process because the merged entity could use its market power to hinder the expansion of smaller firms or potential competitors. Nevertheless, the strength of the merged entity in controlling the supplier or distribution may not be sufficient to restrain market competition. Overestimating its effect will lead to false negative errors.¹⁸

Thirdly, although the market share of acquired entity is trivial, the MOFCOM still raises anti-competitive concerns because merger eliminates an important potential competitor.¹⁹ However, the MOFCOM lacks further reasons and evidence to prove the effects of losing potential competitor on competitive process. False negative errors will result if mergers will not raise significant anti-competitive effects even when a potential entrant is acquired.

1.1.2.1 Recommendations

Firstly, with increasing experience assessment of anti-competitive concerns of a merger should move from reliance on market structure to a more effects-based approach. Apart from considering the market shares of remaining players and the concentration ratio in the relevant market, the EU considers five other factors in

¹⁷ See note 15 in chapter 3.

¹⁸The MOFCOM should be careful of the transaction which does not raise anti-competitive concerns, although merging parties have market power in the procurement market or distribution channel. See '4.2.5 Merged Entity Able Hinder Expansion by Competitors' in chapter 3.

¹⁹See analysis of *Novartis/Alcon* in '3.1 Initial Review of Market Shares and Concentration Ratio' in chapter 3. Announcement MOFCOM [2010] No.53 *Novartis/Alcon*.

deciding the unilateral effects of mergers.²⁰ The MOFCOM should also note the influence of those five factors on the likelihood of unilateral effects post-merger.

Secondly, verification of market effects relies on the notifying and third parties.²¹ The MOFCOM should improve its communication with them. Links between the 'SO' and final decision should be established in every case which might be prohibited or in which significant commitments are required. In addition, in order to encourage the proactive involvement of third parties in its investigations the MOFCOM should give a notice on its website declaring whether a merger is being accepted, or proceeding into phase II. A non-confidential version of the 'SO' should be issued to third parties before the hearing in Phase II if they have shown an interest in the merger. If notifying parties argue that they are not the closest competitors in the relevant market, a merger may be compatible with market competition although the combined market share of merging parties is high. The MOFCOM should investigate customer preference or purchasing patterns through consumer surveys or finding historical evidence. When data are available, a quantitative test can be used to see if various methods lead to the same outcome.

Thirdly, the MOFCOM takes the view that merging parties' control over distribution or supply will hinder the expansion or entry by rival firms because the merged entity would raise the costs or decrease the quality of service of its rival with its market power. However, a merger may not give the merged entity the ability and incentive to do so if, firstly, the merger does not substantially enhance its monopsony. A merged entity still lacks ability and/or incentive to procure materials exclusively from its own upstream entity and foreclose other upstream suppliers from obtaining a sufficient customer base.²² Secondly, the suppliers of

²⁰ Paragraph 28-38, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (hereinafter Guidelines on Horizontal Mergers), [2004] O.J. C31/5.

²¹ If market share exaggerates the anti-competitive concerns of a merger, notifying parties have incentives to clarify the false negative errors as they want their transaction to be cleared. If a small market share has influence on other aspects of market competition, the related third parties have an incentive to point out these false positive errors in order to protect their interests.

²² See discussion about *Seagate/Samsung* in '3.4 Merged Entity Able to Hinder Expansion by Competitors' in chapter 3. Case COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3.

the merged entity might own ‘must-have’ brands; the foreclosure strategy of merging parties would not significantly harm suppliers’ business.

Fourthly, acquiring a potential entrant with a minority market share at present may be detrimental to the competitive process.²³ However, the MOFCOM needs give reasons why a merger with a potential competitor will have significant anti-competitive effects.²⁴

Finally, customers might switch to rivals with upgraded products, although the merged entity has a relatively high market share at the time of merger review. Accordingly, the MOFCOM should investigate the human capital and Intellectual Property of the merged entity with which it seeks to hinder the innovation of its rivals.²⁵ If the market has enough pipeline products or is characterised as active innovation, rivals can realise expansion by developing pipeline products or upgrading their products.

²³ In *Novartis/Alcon* the MOFCOM found that the incumbent market share of Alcon in China was over 60%, while Novartis’ share in relevant market was less than 1%. The MOFCOM still raised anti-competitive concern, although Novartis notified its decision to withdraw its existing operations in the global and Chinese markets for the relevant product. The MOFCOM pointed out that if Novartis’ decision of withdrawing from the market strategically was only for this transaction, it still had the capability of accessing into the market again after the transaction which would restrict or eliminate competition in China. Paragraph 1, Section four, Announcement MOFCOM [2010] No.53 *Novartis/Alcon*.

²⁴ In the EU, ‘for a merger with a potential competitor to have significant anti-competitive effects, two basic conditions must be fulfilled. First, the potential competitor must already exert a significant constraining influence or there must be a significant likelihood that it would grow into an effective competitive force. Evidence that a potential competitor has plans to enter a market in a significant way could help the Commission to reach such a conclusion. Second, there must not be a sufficient number of other potential competitors, which could maintain sufficient competitive pressure after the merger.’ See paragraph 60, Guidelines on Horizontal Mergers, note 22 *supra* in this chapter.

²⁵ See ‘2.5 Merger eliminates an important competitive force’ in chapter 3.

1.1.3 Horizontal Mergers--Coordinated Effects

1.1.3.1 Disadvantages

Problems of the MOFCOM's assessment of coordinated effects have been described in chapter 4.²⁶ The following is a summary of these problems and recommendations for improvement.

First of all the MOFCOM is still using a check-list in its assessment of coordinated effects of mergers. In the reported three merger cases concerning coordinated effects the MOFCOM only considered the number of main players in the relevant market, the homogeneity of remaining competitors' products, and the links of coordinating competitors in the form of agreement or structure.²⁷ A number of necessary factors for proving coordinated effects in the EU have not been considered in Chinese published case decisions.²⁸ No rules further clarify whether those neglected factors should be taken into consideration. The drawback of a 'checklist' approach is its unpredictability. The outcome is still uncertain in the light of both plus- and minus- market characteristics of tacit collusion. That the

²⁶See Chapter 4 Horizontal Merger--Coordinated Effects, pp.37-38.

²⁷ See the discussion in '3.1 Checklist Period in China' in chapter 4.

²⁸ *Inbev/AB* was the first merger case cleared by the MOFCOM with restrictive conditions. In this case the relevant market was that of beer in China. Apart from the merging parties, there were four main competitors in the relevant market including China Resource Snow Breweries, Tsingtao Breweries, Beijing Yanjing Breweries and Zhujiang Breweries. Before merger the acquiring firm (Inbev) held a 28.56% stake in Zhujiang Breweries. The acquired firm (AB) owned a 27% stake in Tsingtao Breweries. Remedies were designed to prohibit the merged entity's holding more stake than its pre-merger level in the other four main rivals. Such restriction of cross-shareholding was meant to prevent a potential monopoly agreement or tacit collusion between the merged company and its rivals. Nevertheless, the MOFCOM did not provide any reasoning on the possibility of tacit collusion post-merger, such as how cross-shareholding between the merged entity and its rivals was conducive to tacit collusion and whether entry conditions such as efficient scale of production and brand effect would be barriers of entry which will deter potential entrant from counteracting the price increase of coordinating group. The following were the conditions imposed on the clearance of the transaction: a. AB should not increase its stakes (27%) in Tsingtao Brewery post-merger; b. InBev was obliged to notify MOFCOM of any changes in its controlling shareholders; c. InBev should not acquire further stakes (28.56%) in Zhujiang Breweries; d. Merged entity should not purchase any stake of the other two largest beer producers, China Resources Snow Breweries and Beijing Yanjing Brewery. See point 3, Announcement of MOFCOM [2008] No.95, *Inbev/Anheuser-Busch*.

‘pluses’ outweigh the ‘minuses’ in no way implies coordinated effects are to be expected.²⁹

Causal links between the merger and the coordinated effects are absent in the MOFCOM’s published decisions. The MOFCOM does not consider the competitive situation pre-merger in the market. Merger may not change specific factors which restrain coordination successfully pre-merger. Therefore the coordinated concerns raised by the MOFCOM post-merger may be false negative errors.³⁰

The last question is that of finding a proper standard of proof of coordinated effects. Currently the MOFCOM raises concerns of coordinated effects only if ‘the possibility cannot be ruled out’.³¹ This low standard of proof has two problems. On the one hand, false negative errors will result if tacit collusion is not the most likely possibility post-merger. Ineffective judicial review is not able to make good remedy of such errors; On the other hand, the standard imposes a too heavy burden of proof on the notifying parties. Once coordinated concern is raised by the MOFCOM even without sufficient evidence, merging parties have to collect evidence for the claim that tacit collusion is unlikely to happen post-merger. Especially given that the merging parties do not have any rights to obtain evidence from third parties, they are procedurally barred from discharging this burden.³²

²⁹ Four drawbacks of the check-list approach have been described in ‘2.1.2 An Evaluation of the Checklist Approach’ in chapter 4.

³⁰ In *Seagate/Samsung* the Commission ascertained that ‘Samsung, as the acquired party, was neither a particularly strong innovative force nor a particularly strong competitor. Therefore Samsung is unlikely uniquely to have constrained suppliers’ ability to coordinate or sustain coordination premerger in these markets. The effect of Samsung’s removal is therefore likely to be limited with regard to coordinated effects.’ However, the MOFCOM overestimated the acquired firm’s-Samsung role in market competition and indicated that acquisition would lead to coordination post merger. See paragraphs 549-550, COMP/M.6214 *Seagate Technology/the HDD Business of Samsung Electronics* [2011] O.J. C 165/3.

³¹ Paragraph 3-point 2, Announcement MOFCOM [2011] No.73 *Savio/Penelope*.

³² The MOFCOM have power to obtain evidence from third parties. Its power of investigation in merger reviews regulated in Chapter 6 of the AML 2008, and the MOFCOM announcement [2011] No. 6 Interim Measures on Investigation into and Handling of Concentrations of Business which was promulgated by the MOFCOM on the 30th December 2011, and took effect on the 1st February 2012. An unofficial English version is available in the appendix.

1.1.3.2 Recommendations

In order to solve the uncertainty of the ‘check-list’ approach, the MOFCOM should adopt from the EU an analytical framework within which coordinated effects are analysed. The analytical framework is composed by four conditions which are necessary to establish and keep the equilibrium of tacit collusion.³³

Secondly, some market characters will affect more than one factor composing the analytical framework of coordinated effects.³⁴ Therefore the MOFCOM should learn to interpret the effects of a market character on the likelihood of tacit collusion from multiple aspects.

Thirdly, market investigation should compare the market equilibrium before the merger with what is expected to emerge following it. If a merger does not change those key factors in creating or strengthening a collective dominant position, coordinated effects should be deemed unlikely to happen or be strengthened post-merger. Take *Novartis/Alcon* for instance. Here the MOFCOM was concerned that the Sales and Distribution Agreement between Novartis and Haichang would lead to the combined entity and Haichang to coordinate their products post-merger in matters of price, quantity, and dividing markets post-merger. However, this agreement was in place before the concentration, while there was no coordination pre-merger.³⁵ The agreement was not a key factor deterring successful coordination pre-merger. According to the requirement of causal links between the merger and the coordinated effects, the MOFCOM should prove how those deterring factors of coordination will be changed significantly by a merger. For

³³ The four conditions are: whether competitors post-merger can easily arrive at a common understanding of how the coordination should work, whether there is credible threat of retaliation which prevents firms from deviating; whether there is further retaliation that keeps the coordination sustainable; whether the reaction of outsiders are able to jeopardise the outcome expected from coordination. The MOFCOM did not consider sufficient retaliation to be a necessary condition of keeping coordinating firms from deviating. When considering the reaction of outsiders the MOFCOM neglected that non-coordinating firms in relevant market as well as countervailing buyer power of customers are all able to restrain the outcome expected from coordination apart from potential entry.

³⁴ See point five in ‘2.1.1 Reaching Terms of Coordination’ in Chapter 4.

³⁵ *Novartis/Alcon* was notified to the MOFCOM on the 20th April 2010. Novartis signed a Sales and Distribution Agreement with Haichang in 2008, which made Haichang the sole distributor of Shanghai Shikang in the territory of China. Shanghai Shikang and Haichang had set up a strategic affiliated partnership. See Announcement MOFCOM [2010] No.53 *Novartis / Alcon*.

example, merger acquires an effective non-coordinating firm which reduces the fringe competitive restraint. Thus it permits coordinating firms to coordinate on supra-competitive price post-merger.

Fourthly, the ‘symmetric standard of proof’ in the EU might be too high to be enforced by the MOFCOM at present.³⁶ The MOFCOM should firstly establish an analytical framework within which likelihood of coordinated effects is assessed. Resources and time should be devoted to cases with significant anti-competitive concerns because methods of assessing coordinated effects can be explained through those cases. In the long term, as the MOFCOM becomes more experienced in investigation and balancing various possibilities the standard of proof for clearing a merger should be increased to the same level as decisions of significant coordinated concern.

The final recommendation to the MOFCOM is to be cautious of applying the ‘more economic approach’ in merger review at present. In the EU, there is criticism that the benefits of complex quantitative analysis do not outweigh its cost.³⁷ The stronger economics-based approach increases administrative burden,³⁸ diminished legal certainty³⁹ while the quality of merger decisions are not guaranteed.⁴⁰

³⁶ In the light of the MOFCOM’s limited human resource and experience of merger review, the standard of proof for assessing a merger which will not raise coordination concern significantly might be lower than the standard for assessing a merger which will raise coordination concern at present. See ‘4.3.2 Is a ‘Symmetric’ Standard of Proof Suitable for China?’ in chapter 4.

³⁷ See A Christiansen, The ‘more economic approach’ in EU merger control: A critical assessment, (March, 2006), *Research notes working paper series Note 21.*, pp.1-26. A C Witt, From Airtours to Ryanair: is the more economic approach to EU merger law really about more economics?, *Common Market Law Review*, (2012) Volume 49 Issue 1, pp.217-246.

³⁸ The burden of proof may be divided into two parts, namely the merging parties’ and the antitrust authorities’. In order to use various economic instruments like the HHI test all competitors in the market should prepare their status or economic assessment. Accordingly, to the Commission, more information provided means more pressure to review. See A Christiansen, The ‘more economic approach’ in EU merger control: A critical assessment, (March, 2006), *Research notes working paper series Note 21.*,9.

³⁹ Economics is an ‘inexact’ science. There are constant divergences and many approaches in economic competition theory whose conclusions may be contradictory. A Christiansen proposed a prominent example of the dispute between the ‘Harvard school’ and the ‘Chicago school’ which prevailing until (at least) into the late 1980s. These two economic theories are considerably divergent not only in their theoretical and empirical foundations but also in their normative objectives. The discretion of applying difference models of econometric analysis leads to the uncertainty of merger decision. Other kinds of economic model for competitive assessment is available to at *ibid*, 11.

⁴⁰ Apart from price or output modern economic theory appears difficult to assess the effects of a concrete merger on other market parameters, such as a merger’s potential effects on innovation or

Therefore, in the EU quantitative evidence has only played an accessory role in the Commission's decision practice to date.⁴¹ Since Chinese merger control regime is still at an early stage, it may be too early to introduce the 'more economic approach' in China in order to avoid further legal uncertainty.

1.1.4 Countervailing Effects: Buyer Power and Market Entry

1.1.4.1 Countervailing Buyer Power

The countervailing buyer power is now considered more frequently than before by the MOFCOM.⁴² In most instances insufficient buyer power was one of factors leading to the anti-competitive concerns of mergers.⁴³ No legislation mentioned the method of analysing countervailing buyer power. In *General Motor/Delphi* the MOFCOM did not consider that a majority of buyers of merging parties would switch to alternative suppliers if the combined entity were to increase prices.⁴⁴ In addition, the MOFCOM only considered the incentive of buyers to rebut the price increase of merging parties and the roles of small customers in one case separately.

product quality. In addition, the evidence collected for quantitative analysis presents reliability issues. See '2.2 Merging Firms Are Close Competitors' in chapter 3. Political intervention and rent-seeking is possible under the shield of complex quantitative analysis. For example, economic model can be chosen in favour of clearing a transaction for building 'champions' in the global market or providing special treatment to certain industries. Firms might lobby the staff in antitrust authority for using economic model in their favour. See *ibid*, pp.18-19.

⁴¹ Neither the EUMR nor the Commissions' guidelines require or even refer to the use of quantitative analysis by the Commission, and although the latter new periodically carries out econometric studies to establish certain facts. The Commission generally refers to quantitative analysis only for supporting and complementing the findings of the qualitative analysis. A C Witt, *From Airtours to Ryanair: is the more economic approach to EU merger law really about more economics?*, *supra* note 37, 244.

⁴² By the 30th June 2013 countervailing buyer power had appeared in five published cases, two were the most recent. See Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon* and Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon*.

⁴³ For example, in *Marubeni/Gavilon*, the relevant market was China's import market for soybean, corn, bean pulp and dry and course distillers grains. Chinese soybean crushers were downstream industries of China's import market for soybean. Investigation found the level of concentration among existing Chinese soybean crushers is low. Most of the Chinese soybean crushers have a relatively small production scale, and low bargaining power. The MOFCOM raised anti-competitive concern because this concentration of undertakings will further weaken the bargaining power of Chinese downstream soybean crushers. See Announcement MOFCOM [2013] No.22 *Marubeni/Gavilon*.

⁴⁴ See the study of *General Motor/Delphi* in '2.2.1 The Existence of Viable Alternatives or Credible Threats' in chapter 5. See Announcement MOFCOM [2009] No.76 *General Motors / Delphi*;

In practice the way of assessing countervailing buyer power adopted by the MOFCOM is the same as that of the EU. Three main aspects are considered, namely the presence of available alternatives or threats, the incentive of buyer power, and protection of all consumers. If there are alternative suppliers, consumer investigation like the SSNIP test can be used to determine whether customers would switch to other suppliers when the merged entity increases its price post-merger. Even substitute is available buyers may have no incentive to switch suppliers when prices increase. There are two cases in point concerning HDDs products.⁴⁵ The experience of the EU reminds the MOFCOM of three situations in which buyers may have an incentive to prevent the price increase from suppliers.⁴⁶ Finally, the countervailing buyer power owned by major entities will not be able to protect small/medium companies. The MOFCOM has recognised the concern. The EU raised an exceptional situation in which price discrimination of small/medium consumers will not occur.⁴⁷ The reason for pointing out such exceptional situations is that the MOFCOM gets used to judging an anti-competitive concern without investigating whether any exceptional situations exist. This may lead to false negative errors.

Finally, if countervailing buyer power is sufficient to eliminate anti-competitive concern, a notified transaction will be cleared. The MOFCOM's assessment of buyer power should be revealed in the brief statement of outright clearance.

1.1.4.2 Market Entry

The MOFCOM should consider the likelihood, timeliness and sufficiency of potential entry.⁴⁸ Yet no further guidance clarifies the meaning of these three factors. In all

⁴⁵ Large computer manufacturers have no incentive to constrain the price increase of input, because they can pass the increase part of price on to final consumers by increasing the prices of computer products. See Part II-6, Announcement MOFCOM [2011] No.90 *Seagate / Samsung* and Announcement MOFCOM [2012] No.09 *Western Digital Ireland/Viviti Technologies*.

⁴⁶ Three situations can be seen in '2.3.3 Situation of Price Discrimination' in chapter 5.

⁴⁷ The study on *Enso/Stora* is available at '2.1.3 The Role of Smaller Customers' in chapter 5. Case COMP/M.1225 *Enso/Stora*, [1999] O.J. L 254/9.

⁴⁸ See also articles 7 and 12 of the Interim Rules: 'if barriers to access to the relevant market of merging parties are low, business operators who do not participate in the concentration are able to restrain merging parties to eliminate or restrictive competition post-merger'. Interim Rules on Evaluating Competitive Effects of Concentration of Business Operators (hereinafter the Interim

published cases barriers to market entry were too high to reduce anti-competitive concerns. However, according to the EU's experience, barriers to entry may be temporary or easily broken under certain conditions. A patent is not a barrier if it can be avoided by redesigning at low cost. Technical advantage can be broken if R&D is fast. For example, in the pharmacy market, pipeline products will enter the market when it is ripe.⁴⁹ Missing these exceptional situations may lead to false negative errors.

The MOFCOM should be provided with more and better explanation of how to review the 'likelihood', 'timeliness' and 'sufficiency' of potential entry. In practice entry should be considered likely if the benefit of the supra-competitive price after entry outweighs the costs of overcoming barriers to entry.⁵⁰

1.2 Transparency to the Public

The importance of transparency of merger analysis has been discussed in chapter 1.⁵¹ The following presents problems which deter the public transparency of merger assessment in China. Recommendations are proposed.

1.2.1 *Relevant Market*

1.2.1.1 Disadvantages

The MOFCOM published a Guideline on Relevant Market one year after the AML2008. Both EU and China adopt similar principles and criteria in defining 'relevant market'. However, the MOFCOM did not interpret how those principles and criteria were considered in published case decision.

Rules), (29th August, 2011), MOFCOM Announcement No. 55. The rule has no official English translation. An unofficial English translation is available in the appendix.

⁴⁹ Case COMP/M.5476 *Pfizer / Wyeth*[2009] O.J. C 262/1, paragraph 38.

⁵⁰ See '3.3.1 When the Entry is more likely' in chapter 5.

⁵¹ See '1.3 Transparency of Merger Analysis' in chapter 1.

Since the end of 2012 the MOFCOM began regularly to publish decisions of outright clearance on its official website regularly.⁵² Publication is limited to the name of the case, name of merging parties and the date of approval. The public is not able to scrutinise the enforcement authority's assessment on these notified transactions. In addition, as information on the transaction is revealed to the public after approval, third parties are not able to join in the merger assessment and express their views if the MOFCOM does not invite them.⁵³

1.2.1.2 Recommendations

If the MOFCOM decides to approve notified concentrations unconditionally it should publish a brief statement about the time of merger review, the business activities of the undertakings concerned, the nature of the transaction and the relevant product and geographic market.⁵⁴ This is to prevent the MOFCOM from clearing transactions based on non-competitive considerations, especially since the MOFCOM is under the control of the highest organ of state administration.⁵⁵ The MOFCOM should publish more details of reasoning in merger cases which will be blocked or cleared with commitments. Firstly, the structure of relevant industry involving the affected market should be introduced in the case decision. It is the platform for the public to understand the MOFCOM's subsequent substitute test. Secondly, views of the notifying parties should be revealed in the decision. The MOFCOM should clarify what views of notifying parties has been confirmed by its market investigation. On the other hand, if the notifying parties' arguments are rejected, the MOFCOM should indicate its reasons of rejection with supporting evidence collected in investigation. This is to supervise the MOFCOM's discretion and let the public know what information they submit may be accepted by the

⁵² On the 6th January 2013 the MOFCOM published its outright merger cases during the last quarter of 2012 for the first time. Since then information of outright cases has been published on the MOFCOM's official website at the end of every quarter. Before 2013 there was no information regarding transactions which were cleared outright by the MOFCOM.

⁵³ See '4.6 Transparency of Case Decisions' in chapter 2.

⁵⁴ According to the list released by the MOFCOM, it approved about 50 cases every quarter unconditionally. It may not be a heavy burden on the authority to reveal more information on each case.

⁵⁵ The role of the MOFCOM in implementing non-competitive considerations has been discussed in '4.3.2.2 Mission of Implementing Non-competitive Considerations' in Chapter 1.

MOFCOM. Thirdly, in published case decisions, the MOFCOM should also explain why competitive concerns would not arise in some effected markets. This is to prevent notifying parties from bribing staff in the enforcement authority for clearing a transaction like in *SEB/Supor*.⁵⁶ If the precise scope of relevant market is hard to define, the MOFCOM can leave it open if competitive concerns are not substantial even in the smallest market.

1.2.2 Anti-competitive Assessment of Horizontal Mergers

Unlike its EU counterpart, anti-competitive assessment of horizontal merger in China is not clarified clearly in the legislation. Pursuant to the AML 2008 and the Interim Rules, the MOFCOM will take into account a number of factors in merger assessment.⁵⁷ However, there is no further guidance on how the check-list works in practice. The Guidance on the assessment of horizontal mergers in the EU contains 90 articles and 11,628 words, while the Interim Rules in China has only 14 articles and 2,319 words. This lack of transparency increases the discretion of the MOFCOM and reduces the public's ability to predict. The way of developing guidance in China has been pointed out in each chapter.⁵⁸ In published case decision, views of the parties and results of market investigation should be disclosed. Therefore, the public are able to know what views of the parties have been accepted, and why certain submissions of notifying parties were not agreed by the MOFCOM.

2 Further Studies

This thesis does not aim to solve all substantive problems of merger assessment under the AML 2008. It only provides solutions to two research questions, namely how to make the antitrust horizontal merger assessment in China more effective and transparent through learning from the EU. There are still at least two other problems awaiting investigation.

⁵⁶ A controversial case about bribery is *SEB/Supor*, *supra* note 188 in chapter 2.

⁵⁷ Article 27 of the AML 2008, and Article 5, the Interim Rules.

⁵⁸ See '4.2Recommendations' in chapter 3.

2.1 Anti-competitive Effects of Non-Horizontal Mergers

Two types of non-horizontal merger can be distinguished, vertical and conglomerate.⁵⁹ Non-horizontal mergers are generally less likely significantly to impede effective competition than horizontal mergers.⁶⁰ Unlike horizontal mergers vertical or conglomerate mergers do not entail the loss of direct competitor between the merging firms in the same relevant market. Therefore the main concerns of anti-competitive effect in horizontal merger are not raised in vertical or conglomerate mergers. Non-horizontal merger involving producers of complementary products can also result in improved specialisation, cost reduction, 'internalisation of double mark-ups', economies of scope and other efficiency effects to the manufactures. These efficiencies may give rise to customer benefits such as decrease in price, one-stop shopping and so on.⁶¹ Thus the effects of non-horizontal mergers on competitive process differ from those of horizontal mergers.

Two questions are addressed through comparison of non-horizontal merger assessment in the EU and China. Firstly, comparing the EU and China, in which jurisdiction the non-horizontal merger analysis better predicts the effects of merger on the competitive process. If the EU has more advantages, what can China learn in order to improve its method of non-horizontal merger analysis? Secondly, which jurisdiction shows greater public transparency of merger assessment? If the EU, what can China learn in order to improve such transparency?⁶²

⁵⁹ See paragraph 3, Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (hereinafter the Guidelines on Non-horizontal Mergers), [2008] O.J. C 265/7.

⁶⁰ See paragraph 10, Guidelines on Non-horizontal Mergers; see also J Church, the Impact of Vertical and Conglomerate Mergers on Competition, 2004 (report for DG Competition), available at: http://ec.europa.eu/competition/mergers/studies_reports/merger_impact.pdf (Accessed on 27th March 2012).

⁶¹ Paragraphs 11-14, Guidelines on Non-horizontal Mergers.

⁶² F Alese, (Fore) closing the Gap: the Commission's non-horizontal merger guidelines – a "response" to Simon Bishop, [2008] Volume 29 No.3, *E.C.L.R.*, pp.196-200; T Weck and A Scheidtmann, Non-horizontal Mergers in the Common Market: Assessment under the Competition Commission's Guidelines and beyond, [2008] Volume 29 No.8, *E.C.L.R.*, pp. 480-489; About the adoption process of the Non-horizontal Guidelines can see, CEMosso, Non-horizontal Mergers: A European Perspective, [2007] Volume 31 No.5, *Fordham International Law Journal*, pp. 1457-1459. The Commission has published 32 comments on its Draft Guidelines, which are available at: http://ec.europa.eu/competition/mergers/legislation/files_non_horizontal_consultation/icc.pdf (Accessed on 27th March 2012).

2.2 Defence of Efficiency

According to Article 27 of the AML 2008, in merger review the MOFCOM should consider ‘the influence of the concentration on ‘technological progress’ and ‘the national economic development’. In addition, Article 28 of the AML2008 states that ‘if the business operators concerned can prove that the concentration will bring more positive impact than negative impact on competition, or the concentration is pursuant to public interests, the Anti-monopoly Authority under the State Council may decide not to prohibit the concentration.’ These two articles provide a legal basis for the efficiency defence. However, comparison with the efficiency defence in the EU shows there are a number of problems that impede the predictability of efficiency evaluation.⁶³

First of all it lacks a framework within which to assess the efficiency brought by the concentration; secondly, the AML 2008 does not spell out the welfare standard which the evaluation of efficiency should follow. Under consumer welfare, a merger is deemed anti-competitive if and only if it hurts consumers in the relevant markets. Under the total welfare standard, a merger is deemed anti-competitive if

sed 29th March 2012); G Conte *et al.*, Commission launches public consultation on draft Non-Horizontal Merger Guidelines, (2007) volume 1, *Competition Policy Newsletter*, 16; P. Papandropoulos, What can be expected from the Commission's non-horizontal merger guidelines?, (2007) Volume 1, *Concurrences*, 31; The EAGCP Merger Sub-Group, *Non-Horizontal Mergers Guidelines: Ten Principles*, by the merger sub-group, (August, 2006), available at: http://www.appliedantitrust.com/10_nonhorizontal_mergers/europe/eagcp_non_horizontal_guidelines_8_17_2006.pdf (Accessed on the 3rd April 2012); J Church and University of Calgary of the Department of Economics, *Impact of Vertical and Conglomerate Mergers on Competition*, (September, 2004), available at: http://ec.europa.eu/competition/mergers/studies_reports/merger_impact.pdf (Accessed on the 3rd April 2012); in addition, see SBishop, (Fore)closing the gap: the Commission's draft non-horizontal guidelines, (2008) Volume 29 Issue 1, *E.C.L.R.*, pp.1-4; A Svetlicinii, Assessment of thenon-horizontal mergers: is there a chance for the efficiency defence in EC merger control?, (2007) Volume 28 Issue 10, *E.C.L.R.* pp.529-538; RBB economics, *The Efficiency-Enhancing Effects of Non-Horizontal Mergers*, (2005), available at: http://www.edis.sk/ekes/non_horizontal_mergers.pdf (Accessed on the 3rd April 2012). CEMosso, Non-horizontal Mergers: A European Perspective, (2007) Volume 31 No.5, *Fordham International Law Journal*, pp.1442-1482; G Drauz, Unbundling GE/HONEYWELL: The Assessment of Conglomerate Mergers Under EC Competition Law, (2001) Volume 25 Issue 4, *Fordham International Law Journal*, pp.885-908.

⁶³ P Ying, The Reasons for Antitrust Merger Control: A Undetermined Standpoint [经营者集中反垄断规制的理由: 一个不确定的立场, *JingyingzheJizhongFanlongduanGuizhi de Liyou: YigeBuqueding de Lichang*], (2009) Volume 2, *Anhui University Law Review* [安徽大学法学评论, *Anhui DaxueFaxuePinglun*], pp. 66-74.

and only if it reduces the sum of consumer and producer welfare.⁶⁴ Thirdly, the burden of proof on efficiency defence between the MOFCOM and notifying parties is not allocated. Comparison can be applied for solving the above three problems.⁶⁵

⁶⁴ The main difference between a total welfare and consumer welfare standard lies in the treatment of efficiencies. By the total welfare standard there is no bias in favour of efficiencies which benefit consumers over producers. Under consumer welfare there should be an extra step which is to assess whether any cost savings of producers will be passed on consumers.

⁶⁵ A Lindsay, *The EC Merger Regulation: Substantive issues*, Second Edition, (London, Sweet & Maxwell, 2006), 524. On the development of efficiencies defence in the EU see, Y Liu, Efficiency Defence in Merger Assessment of the EU [欧盟企业合并审查中的效率分析, Oumeng Qiye Hebing Shencha Zhong de Xiaolv Fenxi], (2008) Volume 12, *Political and Law [政治与法律]*, *Zhengzhiyu Falv*, pp. 146-154; C Jones and E Gonzalez, *the EEC Merger Regulation*, (Sweet & Maxwell, 1992), pp. 157-158; D Besanko and D Dranove etc, *Economics of Strategy*, Third Edition, (Wiley, 2003), pp. 27-28. P Ying, The Welfare Standards of Anti-monopoly Control on Concentration of Business Operators: A Comparative Study and the Choice of China [经营者集中反垄断控制的福利标准-类型化之研究及我国的选择, Jingyingzhe Jizhong Fanlongduan Kongzhi de Fuli Biaozhun-Leixinghuazhi Yanjiuji Woguo de Xuanze], (2010) Volume 4, *Journal of Lanzhou Commercial College [兰州商学院学报, Lanzhou Shangxueyuan Xuebao]*, pp. 114-121; P Ying, The Reasons for Antitrust Merger Control: A Undetermined Standpoint [经营者集中反垄断规制的理由: 一个不确定的立场, Jingyingzhe Jizhong Fanlongduan Guizhi de Liyou: Yige Buqueding de Lichang], (2009) Volume 2, *Anhui University Law Review [安徽大学法学评论, Anhui Daxue Faxue Pinglun]*, pp. 66-74; P Ying, Discussion of Factors for Assessing Efficiency Defence in Antitrust Merger review [经营者集中反垄断效率抗辩的适用条件析, Jingyingzhe Jizhong Fanlongduan Xiaolv Kangbian de Shiyong Tiaojian Fenxi], (2010) Volume 6, *Western Law Review [西部法律评论, Xibu Falv Pinglun]*, pp. 29-34; P Ying, On the Applicable Mode of the Efficiency Plea on Antitrust and How to Overcome Its Uncertainty; Y Sun, Analysis of the Protection of Competition Law for Consumers [论竞争法对消费者的保护, Lun Jingzhengfa dui Xiaofeizhe de Baohu], (2008) Volume 4, *Journal of CUPL [中国政法大学学报, Zhongguo Zhengfa Daxue Xuebao]*.

Appendix 1 Anti-Monopoly Law of the People's Republic of China

(Adopted at the 29th meeting of the Standing Committee of the 10th National People's Congress of the People's Republic of China on August 30, 2007)

Translated by China.org.cn, available at

http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm, last visited on 15 November 2013.

Chapter I General Provisions

Article 1 This Law is enacted for the purpose of preventing and restraining monopolistic conducts, protecting fair competition in the market, enhancing economic efficiency, safeguarding the interests of consumers and social public interest, promoting the healthy development of the socialist market economy.

Article 2 This Law shall be applicable to monopolistic conducts in economic activities within the People's Republic of China.

This Law shall apply to the conducts outside the territory of the People's Republic of China if they eliminate or have restrictive effect on competition on the domestic market of the PRC.

Article 3 For the purposes of this Law, "monopolistic conducts" are defined as the following:

- (1) monopolistic agreements among business operators;
- (2) abuse of dominant market positions by business operators; and
- (3) concentration of business operators that eliminates or restricts competition or might be eliminating or restricting competition.

Article 4 The State constitutes and carries out competition rules which accord with the socialist market economy, perfects macro-control, and advances a unified, open, competitive and orderly market system.

Article 5 Business operators may, through fair competition, voluntary alliance, concentrate themselves according to law, expand the scope of business operations, and enhance competitiveness.

Article 6 Any business with a dominant position may not abuse that dominant position to eliminate, or restrict competition.

Article 7 With respect to the industries controlled by the State-owned economy and concerning the lifeline of national economy and national security or the industries implementing exclusive

operation and sales according to law, the state protects the lawful business operations conducted by the business operators therein. The state also lawfully regulates and controls their business operations and the prices of their commodities and services so as to safeguard the interests of consumers and promote technical progresses.

The business operators as mentioned above shall lawfully operate, be honest and faithful, be strictly self-disciplined, accept social supervision, shall not damage the interests of consumers by virtue of their dominant or exclusive positions.

Article 8 No administrative organ or organization empowered by a law or administrative regulation to administer public affairs may abuse its administrative powers to eliminate or restrict competition.

Article 9 The State Council shall establish the Anti-monopoly Commission, which is in charge of organizing, coordinating, guiding anti-monopoly work, performs the following functions:

- (1) studying and drafting related competition policies;
- (2) organizing the investigation and assessment of overall competition situations in the market, and issuing assessment reports;
- (3) constituting and issuing anti-monopoly guidelines;
- (4) coordinating anti-monopoly administrative law enforcement; and
- (5) other functions as assigned by the State Council.

The State Council shall stipulate composition and working rules of the Anti-monopoly Commission.

Article 10 The anti-monopoly authority designated by the State Council (hereinafter referred to as the Anti-monopoly Authority under the State Council) shall be in charge of anti-monopoly law enforcement in accordance with this Law.

The Anti-monopoly Authority under the State Council) may, when needed, authorize the corresponding authorities in the people's governments of the provinces, autonomous regions and municipalities directly under the Central Government to take charge of anti-monopoly law enforcement in accordance with this Law.

Article 11 A trade association shall intensify industrial self-discipline, guide business operators to lawfully compete, safeguard the competition order in the market.

Article 12 For the purposes of this Law,

"business operator" refers to a natural person, legal person, or any other organization that is in the engagement of commodities production or operation or service provision, and

"relevant market" refers to the commodity scope or territorial scope within which the business operators compete against each other during a certain period of time for specific commodities or services (hereinafter generally referred to as "commodities").

Chapter II Monopoly Agreement

Article 13 Any of the following monopoly agreements among the competing business operators shall be prohibited:

- (1) fixing or changing prices of commodities;
- (2) limiting the output or sales of commodities;
- (3) dividing the sales market or the raw material procurement market;
- (4) restricting the purchase of new technology or new facilities or the development of new technology or new products;
- (5) making boycott transactions; or
- (6) other monopoly agreements as determined by the Anti-monopoly Authority under the State Council.

For the purposes of this Law, "monopoly agreements" refer to agreements, decisions or other concerted actions which eliminate or restrict competition.

Article 14 Any of the following agreements among business operators and their trading parties are prohibited:

- (1) fixing the price of commodities for resale to a third party;
- (2) restricting the minimum price of commodities for resale to a third party; or
- (3) other monopoly agreements as determined by the Anti-monopoly Authority under the State Council.

Article 15 An agreement among business operators shall be exempted from application of articles 13 and 14 if it can be proven to be in any of the following circumstances:

- (1) for the purpose of improving technologies, researching and developing new products;
- (2) for the purpose of upgrading product quality, reducing cost, improving efficiency, unifying product specifications or standards, or carrying out professional labor division;
- (3) for the purpose of enhancing operational efficiency and reinforcing the competitiveness of small and medium-sized business operators;
- (4) for the purpose of achieving public interests such as conserving energy, protecting the environment and relieving the victims of a disaster and so on;
- (5) for the purpose of mitigating serious decrease in sales volume or obviously excessive production during economic recessions;
- (6) for the purpose of safeguarding the justifiable interests in the foreign trade or foreign economic cooperation; or
- (7) other circumstances as stipulated by laws and the State Council.

Where a monopoly agreement is in any of the circumstances stipulated in Items 1 through 5 and is exempt from Articles 13 and 14 of this Law, the business operators must additionally prove that the agreement can enable consumers to share the interests derived from the agreement, and will not severely restrict the competition in relevant market.

Article 16 Any trade association may not organize the business operators in its own industry to implement the monopolistic conduct as prohibited by this Chapter.

Chapter III Abuse of Market Dominance

Article 17 A business operator with a dominant market position shall not abuse its dominant market position to conduct following acts:

- (1) selling commodities at unfairly high prices or buying commodities at unfairly low prices;
- (2) selling products at prices below cost without any justifiable cause;
- (3) refusing to trade with a trading party without any justifiable cause;
- (4) requiring a trading party to trade exclusively with itself or trade exclusively with a designated business operator(s) without any justifiable cause;
- (5) tying products or imposing unreasonable trading conditions at the time of trading without any justifiable cause;
- (6) applying dissimilar prices or other transaction terms to counterparties with equal standing;
- (7) other conducts determined as abuse of a dominant position by the Anti-monopoly Authority under the State Council

For the purposes of this Law, "dominant market position" refers to a market position held by a business operator having the capacity to control the price, quantity or other trading conditions of commodities in relevant market, or to hinder or affect any other business operator to enter the relevant market.

Article 18 The dominant market status shall be determined according to the following factors:

- (1) the market share of a business operator in relevant market, and the competition situation of the relevant market;
- (2) the capacity of a business operator to control the sales markets or the raw material procurement market;
- (3) the financial and technical conditions of the business operator;
- (4) the degree of dependence of other business operators upon of the business operator in transactions;
- (5) the degree of difficulty for other business operators to enter the relevant market; and
- (6) other factors related to determine a dominant market position of the said business operator.

Article 19 Where a business operator is under any of the following circumstances, it may be assumed to be have a dominant market position:

- (1) the relevant market share of a business operator accounts for $\frac{1}{2}$ or above in the relevant market;
- (2) the joint relevant market share of two business operators accounts for $\frac{2}{3}$ or above; or
- (3) the joint relevant market share of three business operators accounts for $\frac{3}{4}$ or above.

A business operator with a market share of less than $\frac{1}{10}$ shall not be presumed as having a dominant market position even if they fall within the scope of second or third item.

Where a business operator who has been presumed to have a dominant market position can otherwise prove that they do not have a dominant market, it shall not be determined as having a dominant market position.

Chapter IV Concentration of Business operators

Article 20 A concentration refers to the following circumstances:

- (1) the merger of business operators;
- (2) acquiring control over other business operators by virtue of acquiring their equities or assets; or
- (3) acquiring control over other business operators or possibility of exercising decisive influence on other business operators by virtue of contact or any other means.

Article 21 Where a concentration reaches the threshold of declaration stipulated by the State Council, a declaration must be lodged in advance with the Anti-monopoly Authority under the State Council, or otherwise the concentration shall not be implemented.

Article 22 Where a concentration is under any of the following circumstances, it may not be declared to the Anti-monopoly Authority under the State Council:

- (1) one business operator who is a party to the concentration has the power to exercise more than half the voting rights of every other business operator, whether of the equity or the assets; or
- (2) one business operator who is not a party to the concentration has the power to exercise more than half the voting rights of every business operator concerned, whether of the equity or the assets.

Article 23 A business operator shall, when lodge a concentration declaration with the Anti-monopoly Authority under the State Council, submit the following documents and materials:

- (1) a declaration paper;
- (2) explanations on the effect of the concentration on the relevant market competition;
- (3) the agreement of concentration;

(4) the financial reports and accounting reports of the proceeding accounting year of the business operator; and

(5) other documents and materials as stipulated by the Anti-monopoly Authority under the State Council.

Such items shall be embodied in the declaration paper as the name, domicile and business scopes of the business operators involved in the concentration as well as the date of the scheduled concentration and other items as stipulated by the Anti-monopoly Authority under the State Council.

Article 24 Where the documents or materials submitted by a business operator are incomplete, it shall submit the rest of the documents and materials within the time limit stipulated by the Anti-monopoly Authority under the State Council; otherwise, the declaration shall be deemed as not filed.

Article 25 The Anti-monopoly Authority under the State Council shall conduct a preliminary review of the declared concentration of business operators, make a decision whether to conduct further review and notify the business operators in written form within 30 days upon receipt of the documents and materials submitted by the business operators pursuant to Article 23 of this Law. Before such a decision made by the Anti-monopoly Authority under the State Council, the concentration may be not implemented.

Where the Anti-monopoly Authority under the State Council decides not to conduct further review or fails to make a decision at expiry of the stipulated period, the concentration may be implemented.

Article 26 Where the Anti-monopoly Authority under the State Council decides to conduct further review, they shall, within 90 days from the date of decision, complete the review, make a decision on whether to prohibit the concentration, and notify the business operators concerned of the decision in written form. A decision of prohibition shall be attached with reasons therefor. Within the review period the concentration may not be implemented.

Under any of the following circumstances, the Anti-monopoly Authority under the State Council may notify the business operators in written form that the time limit as stipulated in the preceding paragraph may be extended to no more than 60 days:

- (1) the business operators concerned agree to extend the time limit;
- (2) the documents or materials submitted are inaccurate and need further verification;
- (3) things have significantly changed after declaration.

If the Anti-monopoly Authority under the State Council fails to make a decision at expiry of the period, the concentration may be implemented.

Article 27 In the case of the examination on the concentration of business operators, it shall consider the relevant elements as follows:

- (1) the market share of the business operators involved in the relevant market and the controlling power thereof over that market,
- (2) the degree of market concentration in the relevant market,
- (3) the influence of the concentration of business operators on the market access and technological progress,
- (4) the influence of the concentration of business operators on the consumers and other business operators,
- (5) the influence of the concentration of business operators on the national economic development, and
- (6) other elements that may have an effect on the market competition and shall be taken into account as regarded by the Anti-monopoly Authority under the State Council.

Article 28 Where a concentration has or may have effect of eliminating or restricting competition, the Anti-monopoly Authority under the State Council shall make a decision to prohibit the concentration. However, if the business operators concerned can prove that the concentration will bring more positive impact than negative impact on competition, or the concentration is pursuant to public interests, the Anti-monopoly Authority under the State Council may decide not to prohibit the concentration.

Article 29 Where the concentration is not prohibited, the Anti-monopoly Authority under the State Council may decide to attach restrictive conditions for reducing the negative impact of such concentration on competition.

Article 30 Where the Anti-monopoly Authority under the State Council decides to prohibit a concentration or attaches restrictive conditions on concentration, it shall publicize such decisions to the general public in a timely manner.

Article 31 Where a foreign investor merges and acquires a domestic enterprise or participate in concentration by other means, if state security is involved, besides the examination on the concentration in accordance with this Law, the examination on national security shall also be conducted in accordance with the relevant State provisions.

Chapter V Abuse of Administrative Power to Eliminate or Restrict Competition

Article 32 Any administrative organ or organization empowered by a law or administrative regulation to administer public affairs may not abuse its administrative power, restrict or restrict in a disguised form entities and individuals to operate, purchase or use the commodities provided by business operators designated by it.

Article 33 Any administrative organ or organization empowered by a law or an administrative regulation to administer public affairs may not have any of the following conducts by abusing its administrative power to block free circulation of commodities between regions:

- (1) imposing discriminative charge items, discriminative charge standards or discriminative prices upon commodities from outside the locality,

(2) imposing such technical requirements and inspection standards upon commodities from outside the locality as different from those upon local commodities of the same classification, or taking such discriminative technical measures as repeated inspections or repeated certifications to commodities from outside the locality, so as to restrict them to enter local market,

(3) exerting administrative licensing specially on commodities from outside the locality so as to restrict them to enter local market,

(4) setting barriers or taking other measures so as to hamper commodities from outside the locality from entering the local market or local commodities from moving outside the local region, or

(5) other conducts for the purpose of hampering commodities from free circulation between regions.

Article 34 Any administrative organ or organization empowered by a law or administrative regulation to administer public affairs may not abuse its administrative power to reject or restrict business operators from outside the locality to participate in local tendering and bidding activities by such means as imposing discriminative qualification requirements or assessment standards or releasing information in an unlawful manner.

Article 35 Any administrative organ or organization empowered by a law or administrative regulation to administer public affairs may not abuse its administrative power to reject or restrict business operators from outside the locality to invest or set up branches in the locality by imposing unequal treatment thereupon compared to that upon local business operators.

Article 36 Any administrative organ or organization empowered by a law or administrative regulation to administer public affairs may not abuse its administrative power to force business operators to engage in the monopolistic conducts as prescribed in this Law.

Article 37 Any administrative organ may not abuse its administrative power to set down such provisions in respect of eliminating or restricting competition.

Chapter VI Investigation into the Suspicious Monopolistic Conducts

Article 38 The anti-monopoly authority shall make investigations into suspicious monopolistic conducts in accordance with law.

Any entity or individual may report suspicious monopolistic conducts to the anti-monopoly authority. The anti-monopoly authority shall keep the informer confidential.

Where an informer makes the reporting in written form and provides relevant facts and evidences, the anti-monopoly authority shall make necessary investigation.

Article 39 The anti-monopoly authority may take any of the following measures in investigating suspicious monopolistic conducts:

(1) conducting the inspection by getting into the business premises of business operators under investigation or by getting into any other relevant place,

(2) inquiring of the business operators under investigation, interested parties, or other relevant entities or individuals, and requiring them to explain the relevant conditions,

(3) consulting and duplicating the relevant documents, agreements, account books, business correspondences and electronic data, etc. of the business operators under investigation, interested parties and other relevant entities or individuals,

(4) seizing and detaining relevant evidence, and

(5) inquiring about the business operators' bank accounts under investigation.

Before the measures as prescribed in the preceding paragraph are approved, a written report shall be submitted to the chief person(s)-in-charge of the anti-monopoly authority.

Article 40 When inspecting suspicious monopolistic conducts, there shall be at least two law enforcers, and they shall show their law enforcement certificates.

When inquiring about and investigating suspicious monopolistic conducts, law enforcers shall make notes thereon, which shall bear the signatures of the persons under inquiry or investigation.

Article 41 The anti-monopoly authority and functionaries thereof shall be obliged to keep confidential the trade secrets they have access to during the course of the law enforcement.

Article 42 Business operators, interested parties and other relevant entities and individuals under investigation shall show cooperation with the anti-monopoly authority in performing its functions, and may not reject or hamper the investigation by the anti-monopoly authority.

Article 43 Business operators, interested parties under investigation have the right to voice their opinions. The anti-monopoly authority shall verify the facts, reasons and evidences provided by the business operators, interested parties under investigation.

Article 44 Where the anti-monopoly authority deems that a monopolistic conduct is constituted after investigating and verifying a suspicious monopolistic conduct, it shall make a decision on how to deal with the monopolistic conduct, and publicize it.

Article 45 As regards a suspicious monopolistic conduct that the anti-monopoly authority is investigating, if the business operators under investigation promise to eliminate the impact of the conduct by taking specific measures within the time limit prescribed by the anti-monopoly authority, the anti-monopoly authority may decide to suspend the investigation. The decision on suspending the investigation shall specify the specific measures as promised by the business operators under investigation.

Where the anti-monopoly authority decides to suspend the investigation, it shall supervise the implementation of the promise by the relevant business operators. If the business operators keep their promise, the anti-monopoly authority may decide to terminate the investigation.

However, the anti-monopoly authority shall resume the investigation, where

(1) the business operators fail to implement the promise,

(2) significant changes have taken place to the facts based on which the decision on suspending the investigation was made; or

(3) the decision on suspending the investigation was made based on incomplete or inaccurate information provided by the business operators.

Chapter VII Legal Liabilities

Article 46 Where business operators reach an monopoly agreement and perform it in violation of this Law, the anti-monopoly authority shall order them to cease doing so, and shall confiscate the illegal gains and impose a fine of 1% up to 10% of the sales revenue in the previous year. Where the reached monopoly agreement has not been performed, a fine of less than 500,000 yuan shall be imposed.

Where any business operator voluntarily reports the conditions on reaching the monopoly agreement and provides important evidences to the anti-monopoly authority, it may be imposed a mitigated punishment or exemption from punishment as the case may be.

Where a guild help the achievement of a monopoly agreement by business operators in its own industry in violation of this Law, a fine of less than 500,000 yuan shall be imposed thereupon by the anti-monopoly authority; in case of serious circumstances, the social group registration authority may deregister the guild.

Article 47 Where any business operator abuses its dominant market status in violation of this Law, it shall be ordered to cease doing so. The anti-monopoly authority shall confiscate its illegal gains and impose thereupon a fine of 1% up to 10% of the sales revenue in the previous year.

Article 48 Where any business operator implements concentration in violation of this Law, the anti-monopoly authority shall order it to cease doing so, to dispose of shares or assets, transfer the business or take other necessary measures to restore the market situation before the concentration within a time limit, and may impose a fine of less than 500,000 yuan.

Article 49 The specific amount of the fines as prescribed in Articles 46 through 48 shall be determined in consideration of such factors as the nature, extent and duration of the violations.

Article 50 Where any loss was caused by a business operator's monopolistic conducts to other entities and individuals, the business operator shall assume the civil liabilities.

Article 51 Where any administrative organ or an organization empowered by a law or administrative regulation to administer public affairs abuses its administrative power to eliminate or restrict competition, the superior authority thereof shall order it to make correction and impose punishments on the directly liable person(s)-in-charge and other directly liable persons. The anti-monopoly authority may put forward suggestions on handling according to law to the relevant superior authority.

Where it is otherwise provided in a law or administrative regulation for the handling the organization empowered by a law or administrative regulation to administer public affairs who abuses its administrative power to eliminate or restrict competition, such provisions shall prevail.

Article 52 As regards the inspection and investigation by the anti-monopoly authority, if business operators refuse to provide related materials and information, provide fraudulent materials or information, conceal, destroy or remove evidence, or refuse or obstruct investigation in other ways, the anti-monopoly authority shall order them to make rectification, impose a fine of less than 20,000 yuan on individuals, and a fine of less than 200,000 yuan on entities; and in case of serious circumstances, the anti-monopoly authority may impose a fine of 20,000 yuan up to 100,000 yuan on individuals, and a fine of 200,000 yuan up to one million yuan on entities; where a crime is constituted, the relevant business operators shall assume criminal liabilities.

Article 53 Where any party concerned objects to the decision made by the anti-monopoly authority in accordance with Articles 28 and 29 of this Law, it may first apply for an administrative reconsideration; if it objects to the reconsideration decision, it may lodge an administrative lawsuit in accordance with law.

Where any party concerned is dissatisfied with any decision made by the anti-monopoly authority other than the decisions prescribed in the preceding paragraph, it may lodge an application for administrative reconsideration or initiate an administrative lawsuit in accordance with law.

Article 54 Where any functionary of the anti-monopoly authority abuses his/her power, neglects his/her duty, seeks private benefits, or discloses trade secrets he/she has access to during the process of law enforcement, and a crime is constituted, he/she shall be subject to the criminal liability; where no crime is constituted, he/she shall be imposed upon a disciplinary sanction.

Chapter VIII Supplementary Provisions

Article 55 This Law does not govern the conduct of business operators to exercise their intellectual property rights under laws and relevant administrative regulations on intellectual property rights; however, business operators' conduct to eliminate or restrict market competition by abusing their intellectual property rights shall be governed by this Law.

Article 56 This Law does not govern the ally or concerted actions of agricultural producers and rural economic organizations in the economic activities such as production, processing, sales, transportation and storage of agricultural products.

Article 57 This Law shall enter into force as of August 1, 2008

Appendix 2 Interim Provisions on Assessment of Impact of Concentration of Business Operators on Competition

Translated by Linklaters LLP, available at

<http://www.linklaters.com/Publications/AsiaNews/LinkstoChina/Pages/MOFCOMs-new-interim-provisions-on-assessment-of-anti-competitive-effects-of-mergers.aspx>, last visited on 15 November 2013.

Circular of the Ministry of Commerce of the People's Republic of China No. 55 of 2011

To standardise the assessment of the impact of concentration of business operators on competition in anti-monopoly review and to provide guidance to business operators in respect of the proper notification of the concentration of business operators, the Ministry of Commerce has formulated the Interim Provisions on Assessment of Impact of Concentration of Business Operators On Competition in accordance with the Anti-monopoly Law of the People's Republic of China, the Measures for Notification of Concentration of Business Operators and the Measures for Review of Concentration of Business Operators. These Interim Provisions are hereby promulgated for implementation as from 5 September 2011.

Ministry of Commerce of the People's Republic of China

29 August 2011

Article 1 These Provisions are formulated in accordance with the *Anti-monopoly Law of the People's Republic of China* for the purpose of standardising the anti-monopoly review of the concentration of business operators and the assessment of the impact of the concentration of business operators on competition, as well as providing guidance to business operators in respect of the proper notification of the concentration of business operators.

Article 2 The Ministry of Commerce conducts anti-monopoly review of the concentration of business operators in accordance with law.

Article 3 The following factors must be considered comprehensively based on the particular facts and characteristics of each case when reviewing the concentration of business operators:

(1) The market share accounted for by the business operators participating in the concentration in the relevant market and their market control power;

- (2) The degree of concentration in the relevant market;
- (3) The impact of the concentration of business operators on market entry and technological advancement;
- (4) The impact of the concentration of business operators on consumers and other relevant business operators;
- (5) The impact of the concentration of business operators on the development of the national economy; and
- (6) Other factors having an impact on market competition which should be taken into consideration.

Article 4 When assessing the potential negative impact of the concentration of business operators on competition, the first consideration is whether the concentration will give a business operator the ability, motive and possibility to independently eliminate or restrict competition or will increase such ability, motive and possibility.

Where there are a small number of business operators in the market to which the concentration relates, it must also be considered whether the concentration will give the relevant business operators the ability, motive and possibility to jointly eliminate or restrict competition or will increase such ability, motive and possibility.

Where the business operators participating in the concentration are not actual or potential competitors in the same relevant market, the review must focus on whether the concentration will or might have the effect of eliminating or restricting competition in the upstream and downstream markets or associated markets.

Article 5 Market share is an important factor in analysing the structure of the relevant market and the position of the business operators and their competitors in the relevant market. Market share is a direct reflection of the structure of the relevant market and the position of the business operators and their competitors in the relevant market.

The following factors must be considered comprehensively when determining whether the business operators participating in the concentration will acquire or increase its market control power:

- (1) The market share accounted for by the business operators participating in the concentration in the relevant market and the competition conditions in the relevant market;
- (2) The substitutability of the products or services of the business operators participating in the concentration;
- (3) The productivity of those business operators in the relevant market who are not participating in the concentration, and the substitutability of their products or services for the products or services of the business operators participating in the concentration;
- (4) The ability of the business operators participating in the concentration to control the sales market or the raw materials procurement market;
- (5) The ability of the buyers of the goods of the business operators participating in the concentration to change their suppliers;
- (6) The financial and technical strengths of the business operators participating in the concentration;
- (7) The purchase power of the downstream customers of the business operators participating in the concentration;
- (8) Other factors which should be taken into consideration.

Article 6 Market concentration is a way to describe the structure of the relevant market which reflects the degree of concentration of the business operators in the relevant market. Market concentration is often measured by the Herfindahl-Hirschman Index (or “HHI”, hereinafter referred to as the “Herfindahl Index”) and the combined market share of the top N enterprises in the industry (or “CRn”, hereinafter referred to as the “n-firm concentration ratio”). The Herfindahl Index is the sum of squared market share of each business operator in the relevant market. The n-firm concentration ratio is the sum of market share of the top N enterprises in the relevant market.

Market concentration is one of the important factors to be considered when assessing the impact of the concentration of business operators on competition. Generally speaking, the more concentrated the relevant market is, the greater will be the increase in market concentration following the concentration, and more possible it will be for the concentration to have the effect of eliminating or restricting competition.

Article 7 The concentration of business operators may raise the barriers for entering the relevant market. After concentration, the business operators may make use of the market control power they acquire or increase through concentration to make it more difficult for other business operators to enter the relevant market by controlling the essential factors of production, sales channels, technological advantages and key facilities etc..

When assessing the impact of the concentration of business operators on competition, the counterbalance by potential competitors entering the market could be taken into consideration.

If entry to the relevant market to which the concentration relates is very easy, business operators not participating in the concentration will be able to react to and restrain the actions taken by the business operators participating in the concentration to eliminate or restrict competition.

The possibility, timeliness and adequacy of entry must all be taken into consideration when determining whether it is easy to enter a market.

Article 8 Through concentration, business operators can better integrate the resources and capacity required for technological research and development. This will have a positive impact on technological advancement and offset the negative impact of the concentration on competition. The positive impact of technological advancement can also benefit the consumers.

Concentration may also have a negative impact on technological advancement in the following ways: easing the competitive pressure on the business operators participating in the concentration, reducing their motivation and input to technological innovation; enabling the business operators participating in the concentration to increase their market control through concentration and hinder the investment in and the research and development as well as utilisation of relevant technologies by other business operators.

Article 9 As the concentration of business operators can improve economic efficiency, achieve the economies of scale and economies of scope, reduce production cost and increase product variety, it can be beneficial to consumers.

Concentration may also increase the market control of the business operators participating in the concentration and increase their ability to take actions to eliminate or restrict competition, thus making it more likely for them to prejudice the interests of consumers through price increases, quality degrading, restricting output and sales, and reducing investment in technological research and development etc.

Article 10 Concentration of business operators can increase the competitive pressure on business operators in the relevant market, thus driving other business operators to improve product quality and reduce product prices, thereby benefiting consumers.

With the market control acquired or increased through concentration, business operators participating in the concentration could, by implementing certain operational strategies or measures, restrict the business operators not participating in concentration from enlarging their operation scale or weaken their competitiveness, so as to reduce competition in the relevant market, or eliminate or restrict competition in the upstream and downstream markets or the associated markets.

Article 11 Concentration of business operators will facilitate the expansion of business scale and the increase of market competitiveness, thereby increasing economic efficiency and promoting the development of the national economy.

Under certain circumstances, concentration of business operators could also prejudice the effective competition in the relevant market and the sound development of the relevant industries, thus having an adverse effect on the national economy.

Article 12 In addition to the factors above, some other factors must also be taken into consideration comprehensively when assessing a concentration of business operators. These factors include the impact of the concentration on public interests and economic efficiency, whether the business operators participating in the concentration are on the verge of bankruptcy, and whether there exists any countervailing buyer power.

Article 13 If the concentration of business operators will or may have the effect of eliminating or restricting competition, the Ministry of Commerce must make a decision to prohibit such concentration. However, if the business operators can prove that the positive impact of the concentration on competition obviously outweighs its negative impact, or that the concentration is in the interest of the community or the public, the Ministry of Commerce may decide not to prohibit the concentration.

With regard to any concentration of business operators which is not prohibited, the Ministry of Commerce may decide to impose restrictive conditions to reduce the negative impact of the concentration on competition.

Article 14 These Interim Provisions will be implemented as from 5 September 2011.

Appendix 3 the Raw Statistics of Mergers Notified to the MOFCOM¹

Year	Notificatio ns	Filing accepted	Complete d reviews	Withdrawn	Cleared unconditionall y	Cleared conditionall y	Blocked
2008			17		16	1	0
2009			80			4	1
2010			117			1	0
2011	203	185	168	5	159	4	0
2012	201	186	154	6	142	6	0
1-3/2013					45	0	0
4-6/2013					56	2	0

¹ Statistics between 2008 and 2012 is copied from M Furse, Merger Control in China: Four and a Half Years of Practice and Enforcement-A Critical Analysis, (2013) Volume 36 Issue 2, *World Competition: Law and Economics Review*, pp. 285-313.

Appendix 4 Rules and Guidance Published in Relation to Merger Control in China until 30 June 2013²

Instrument	Date of enactment
Rules of the State Council on notification threshold for concentrations of undertakings ('Notification Threshold')	1 August 2008
Guidance for notification of concentrations of undertakings ('Notification Guidance')	7 January 2009
Guidance for notification documents and materials for concentrations of undertakings ('Notification Documents etc')	7 January 2009
Guidelines on the definition of the relevant market ('Market Definition Guidance')	24 May 2009
Measures on calculation of turnover for notification of concentrations of financial institutions ('Measures on Turnover')	15 June 2009 (Entry into force thirty days later)
Measures on the notification of concentrations of undertakings ('Notification Measures')	1 January 2010
Measures on the review of concentrations of undertakings ³ (the 'Review Measures')	1 January 2010
Interpretation on measures on the notification of concentrations of undertakings and measures on the review of concentrations of undertakings ('Interpretation on Notification and Review Measures')	15 January 2010
Provision measures on the implementation of divestiture of assets or businesses imposed on concentrations of undertakings ('Provisional Divestiture Measures')	5 July 2010

² The table is copied from M Furse, *ibid*, 287

³ Replacing the Working guidance on anti-monopoly review of concentrations of undertakings published by MOFCOM on 1 January 2009.

Circular on establishing the mechanism for national security review of mergers and acquisitions of domestic enterprises by foreign investors ('National Security Review Mechanism')	3 February 2011
Provisions of MOFCOM on the implementation of the mechanism for the national security review of mergers and acquisition of domestic enterprises by foreign investors ⁴ ('National Security Review Implementation')	1 September 2011
Interim provision for the assessment of the effects of the concentrations of undertakings on competition ('Competition Assessment')	5 September 2011
Interim measures on the investigation and handling of concentrations of undertakings that have failed to notify in accordance with applicable laws ('Failure to Notify Measures')	1 February 2012

⁴ Replacing the Provisional provisions published by MOFCOM on 4 March 2011.

Appendix 5 Merger Cases Published in China up to 30 June 2013

DATE	Merging Parties	Decision of the MOFCOM	Decision of the Commission	Type of Concentration
18/11/2008	Inbev/Anheuser-Busch	Conditional clearance		Horizontal
18/3/2009	Coca cola/Huiyuan	Blocked		Conglomerate
24/4/ 2009	Mitsubishi Rayon/Lucite	Conditional clearance		Horizontal and Vertical
28/9/2009	General Motors/Delphi	Conditional clearance	Outright Clearance	Vertical
29/9/2009	Pfizer/Wyeth	Conditional clearance	Clearance with Commitments	Horizontal
30/10/2009	Panasonic/Sanyo	Conditional clearance	Clearance with Commitments	Horizontal
13/8/ 2010	Novartis/Alcon	Conditional clearance	Clearance with Commitments	Horizontal
28/6/2011	Uralkali/Silvinit	Conditional clearance		Horizontal
31/10/2011	Savio/Penelope	Conditional clearance		Horizontal
10/11/2011	GE/Shenhua	Conditional		joint venture

		clearance		
12/12/2011	Seagate/Samsung	Conditional clearance	Outright clearance	Horizontal
9/2/2012	Henkel HK/Tiande	Conditional clearance		vertical
2/2/2012	Western Digital/Viviti Technologies	Conditional clearance	Clearance with Commitments	Horizontal
19/5/ 2012	Google/Motorola Mobility	Conditional clearance	Outright Clearance	Vertical
15/6/2012	UTC/Goodrich	Conditional clearance	Clearance with Commitments	Horizontal
13/8/2012	Walmart/Yihaodian	Conditional clearance		Horizontal
6/12/2012	ARM, Giesecke&Devrient and Gemalto	Conditional clearance	Clearance with Commitments	Vertical
16/4/2013	Glencore International/Xstrata	Conditional clearance	Clearance with Commitments	Horizontal
23/4/2013	Marubeni/Gavilon	Conditional clearance	Outright Clearance	Horizontal

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