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MOFCOM approves Walmart’s acquisition of Chinese online supermarket with conditions.

On August 13, 2012, the Anti-Monopoly Bureau of the Ministry of Commerce ("MOFCOM") conditionally approved Walmart’s acquisition of Yishiduo No 1 Store ("No 1 Store"). In its fifteenth conditional clearance since the Chinese Anti-Monopoly Law came into force in 2008 – and already the fifth in 2012 – MOFCOM imposed behavioural remedies on Walmart. The decision does not clearly articulate a competition concern, and the remedies appear to be designed to address industrial and foreign investment goals rather than competition concerns. Sparse reasoning on competition issues which justify remedies continues to be a concern in Chinese merger control.

**MOFCOM’s assessment**

The transaction which was first notified to MOFCOM on 16 December 2011 was structured on two levels: Walmart acquired a controlling stake in Niuhai Holdings ("Niuhai"). Niuhai in turn, via its subsidiary in China, acquired No 1 Store from Shanghai Yishiduo E-Commerce Company Ltd. ("Shanghai Yishiduo"). No 1 Store (called “Yihaodian” in Chinese) is an online supermarket selling products in its own name and providing a platform for third parties to sell their products. The latter service to third parties is a so-called value-added telecommunication services ("VATS") and requires a licence from China’s Ministry of Industry and Information Technology ("MIIT").

In its decision, MOFCOM defined China’s B2C online retail market as the relevant market. It found that No 1 Store is the largest online supermarket in China. Walmart on the other hand was found to be a main competitor both in the global and Chinese physical supermarket business. MOFCOM found that Walmart possessed several competitive advantages, including a highly developed warehousing and goods dispatching logistics system, broad sources of supplies and a famous brand. MOFCOM’s concern was that post-transaction Walmart would have the ability to transfer this competitive strength to the online retail business of No 1 Store. The decision did not explain why, if Walmart were to do so, the competitive process or Chinese consumers would be harmed.
In addition, MOFCOM investigated the possible impact of the transaction on China’s VATS market. The concern was that post-transaction, No 1 Store would be able to combine Walmart’s and No 1 Store’s respective strengths in the physical and online retail business to expand quickly in the VATS market, achieve a favourable position in that market and strengthen substantially its bargaining power against its platform customers, which may have the effect of excluding or restricting competition on the VATS market in China. The decision did not explain why post transaction, Walmart would have the ability or incentive to do so and why, if such expansion were to occur, the competitive process or Chinese consumers would be harmed.

**Behavioural remedies**

To eliminate its concerns, MOFCOM imposed three restrictive conditions on Walmart:

> Walmart, via Niuhai, is only permitted to acquire the part of No 1 Store’s online business which concerns the sale of its own products (i.e. Shanghai Yishiduo will keep the VATS licence to provide platform services to third parties);

> Unless having obtained its own licence to conduct VATS business, No 1 Store shall not offer any platform services to third parties;

> Walmart shall not provide VATS in cooperation with Shanghai Yishiduo via a so-called Variable Interest Entity (“VIE”).

**Observations**

The details of MOFCOM’s competitive concerns remain vague. In contrast with MOFCOM’s usual practice, the decision does not address the parties’ and their respective competitors’ market shares or other aspects of competition analysis.

The remedies seem to address only one of MOFCOM’s apparent competition concerns, namely that post transaction Walmart and No 1 Store might leverage their combined strength into the VATS business. MOFCOM prevents Walmart from providing platform services to third parties via No 1 Store (first remedy). However, MOFCOM imposes no limitation on Walmart taking over No 1 Store’s B2C business and thereby combine the parties’ respective strengths in the physical and online supermarket businesses.

The second and third remedies seem to focus on industry policy concerns and foreign investment approval requirements for the telecom sector:

> The second condition does not appear to be a remedy, because under the relevant telecom regulations Walmart is prohibited from conducting VATS business without a VATS licence anyway.

> The third remedy appears to be driven by the concern of a potential circumvention of the second remedy by Walmart via a VIE structure. Variable Interest Entities are investment structures commonly used in sectors that have restrictions on foreign investment in China, and
usually involve complex contractual arrangements which allow foreign investors to effectively control domestic companies holding relevant approvals or licenses which cannot be obtained by foreign-controlled companies. Telecom is one of such heavily regulated sectors and subject to stringent foreign investment restrictions. While the decision itself does not clearly comment on the legality of such structures, it may be viewed as a signal that companies which use VIE structures to avoid foreign investment restrictions may face scrutiny from Chinese authorities, including MOFCOM in its merger control review.

It is common knowledge that MOFCOM often conducts extensive and time-consuming consultation with other regulators on non-competition related issues. The sparse reasoning and the nature of commitments in this decision suggests that MOFCOM may impose merger remedies to promote industry and foreign investment goals; on occasion this happens also in other jurisdictions. It is however important, especially in a relatively new competition law jurisdiction, that decisions clearly explain the nature of competition concerns, why remedies are necessary and how adopted remedies address these concerns. Such explanations promote predictability of the process, for the standing of the competition authority and ultimately the investment climate.

MOFCOM is currently revising the rules on restrictive conditions for merger review cases. Linklaters was invited to provide comments on the draft rules. We understand that the new remedy rules are to be promulgated within this year to replace the existing Interim Provision on Divestiture of Assets or Business for Concentration of Business Operators adopted by MOFCOM in 2010.

For MOFCOM’s decision, please click here for the Chinese version and here for the English translation.