e-Competitions
National Competition Laws Bulletin

April I- 2013

The Chinese MOFCOM enforces telecoms regulations in AML merger review (Wal-Mart/Yihaodian)

China, Mergers, Dominant position, Relevant market, Barriers to entry, Geographic market, Remedies (mergers), Market definition, Market power, Effect on competition, Anticompetitive object/effect, Distribution/Retail, Telecommunications

Chinese Ministry of Commerce, 13 August 2012, Announcement No. 49 (2012), regarding concentration anti-monopoly review decision granting conditional approval of Walmart, Inc. acquisition of 33.6% of the voting rights in Newheight Holdings

Yee Wah Chin, e-Competitions | N° 51263, www.concurrences.com

The notification for the *Wal-Mart/Yihaodian* transaction was submitted to China's Ministry of Commerce on 16 December 2011. It was ultimately accepted on 16 February 2012 by MOFCOM after supplementation. At the expiration of the Phase III, or extended Phase II, period, on 13 August 2012, MOFCOM issued its decision granting conditional approval of the transaction.

The transaction itself, and therefore the conditions imposed, is opaque, in significant part because of the opacity and legal ambiguity of the Variable Interest Entity (VIE) structure involved in the control of *Yihaodian*. VIE structures are common in China to bypass restrictions on foreign investment. Until 2010, China required licenses for any foreign company selling its own products directly online. Licenses are still required for a foreign entity seeking to provide an online platform for third party retailers or other telecommunications services, and are difficult to obtain. In a VIE arrangement, management control without formal ownership by a foreign entity of a domestic Chinese telecoms licensee is achieved through contractual arrangements with intermediary entities.

Wal-Mart Stores, Inc. would have, as a result of the transaction, indirect ownership of 51% of *Newheight Holdings Ltd.* (Cayman). *Newheight Holdings*, through its indirect subsidiary *Newheight Shanghai*, controls *Yishiduo E-Commerce Co. Ltd.*'s online retail store *Yihaodian*, apparently through a VIE. *Wal-Mart* appears to be gaining control of *Yihaodian*'s online retail store by stepping into the shoes of *Newheight Holdings* in the VIE. *Yihaodian* also provides a platform for third party sellers à la *Amazon.com*, which are considered "value added telecoms services".

MOFCOM concluded that the relevant product market is the B2C online retail business and the relevant geographic market is China. It found that *Wal-Mart* is a major competitor globally and in China in chain supermarkets, focused on brick and mortar stores, and that *Yihaodian* is China's largest online supermarket, with thousands of suppliers and hundreds of branding partners.

MOFCOM determined that *Wal-Mart* would have the ability after the transaction to extend its competitive strength in brick and mortar retailing to substantially increase the competitiveness of *Yihaodian*'s online retail business. It stated without further explanation that it therefore investigated into the potential impact of the transaction on "value added telecoms services", and concluded that, post-transaction, the combined entity's strength in brick and mortar and online retailing might be leveraged into a dominant position in "value added telecoms services", to a stronger bargaining position relative to users of those services, and thus to eliminate or restrict competition in "value added telecoms services" in China.

MOFCOM concluded that *Wal-Mart*'s acquisition of an additional 33.6% of the voting rights in *Newheight Holdings*, leading to control over *Yihaodian*'s online retail store, has the potential to eliminate and restrict competition. It therefore conditioned approval of the transaction on:

- 1. The acquisition of *Newheight Shanghai* being limited to that part engaged in direct online retailing on its own platform.
- 2. Without approval for value added telecoms services, after the transaction *Newheight Shanghai* may not use its platform to provide network services to others.
- 3. Post-transaction, *Wal-Mart* may not use a VIE structure to conduct the value added telecoms services business now conducted by *Yishiduo E-Commerce*.

The conclusion that the acquisition by a major brick and mortar retailer of a large online retailer threatens competition in "value added telecoms services" was stated without any discussion of how that conclusion was reached. By analogy, while in the United States *Amazon.com* has become a major platform for third party online retail sales, it is difficult to see how a combination of *Amazon.com* with a major brick and mortar retailer would increase *Amazon.com*'s leverage with third party retailers who use *Amazon.com*'s online retail platform.

MOFCOM's decision appears basically to clear *Wal-Mart*'s "acquisition" of *Yihaodian*'s online retail store, the aspect of the transaction likeliest to have competitive consequences, while prohibiting *Wal-Mart* from entering the value added telecoms services business unless *Newheight Holdings*'s subsidiary *Newheight Shanghai* gets a license to conduct that business. Thus, MOFCOM appears to be recognizing the existence of a VIE structure that would permit *Wal-Mart* to control an online retail store, while requiring the unwinding of any VIE to the extent it enabled control by *Newheight Shanghai* over *Yihaodian*'s business of providing an online retail platform for others. Presumably if *Newheight Shanghai* obtained the requisite licenses, *Wal-Mart* would be able to enter the value added telecoms services business, regardless of competitive consequences. The decision essentially mandates compliance with foreign investment and sectoral regulations.

The results in *Wal-Mart*'s acquisition of control of *Yihaodian* is a reminder that non-competition factors play significant roles in AML merger control. MOFCOM's decision in *Wal-Mart/Yihaodian* may be a striking "throw back" to the Coca-Cola/Huiyuan and Mitsubishi Rayon/Lucite approaches of 2009. Unlike the recent detailed decisions in Seagate/Samsung, Western Digital/Hitachi and Google/Motorola Mobility, the *Wal-Mart/Yihaodian* decision is almost as brief as the earliest decisions. The competition analysis presented in the decision has little to do with the remedy imposed. The conditions imposed effectuate industrial and/or regulatory policy more than they ameliorate any threat to competition.

Yee Wah Chin | Ingram Yuzek Gainen Carroll & Bertolotti LLP (New York) | ywchin@ingramllp,com