

Commentary on MOFCOM's Conditional Approval of NXP's Acquisition of Freescale

Michael Gu¹

Partner, AnJie Law Firm

Introduction

On 27 November 2015, the Ministry of Commerce (“**MOFCOM**”) granted clearance to the proposed acquisition of Freescale Semiconductor Inc. (“**Freescale**”) by NXP Semiconductors N.V. (“**NXP**”). This is the second conditional clearance case in the 2015 merger review.

NXP is a global semiconductor firm mainly engaged in the design, manufacture and sale of integrated circuits (**ICs**) and discrete components. Its products are used in various sectors, including the automotive, wireless network infrastructure, lighting, mobile, consumer and computer industries. The target company, Freescale, is mainly engaged in the manufacture and R&D of microcontrollers and digital networking processors (embedded processors). Freescale also provides customized semiconductor products to clients to complement its embedded processing solutions.

After conducting detailed analysis of the impact the concentration of undertakings may have on the relevant product markets, MOFCOM established that the proposed deal could eliminate or restrict competition in the radio frequency (**RF**) power transistor product market. MOFCOM comprehensively evaluated the remedies submitted by NXP, which includes the divestment of NXP's RF power transistor business, and eventually granted conditional clearance to the proposed acquisition of Freescale based on NXP's commitments. This is the only conditional clearance case granted by MOFCOM in the last three years, with the condition that the parties adopt the structural remedy of divesting business that may have negative effects on competition in the relevant market. As this deal involves a global notification, it obtained conditional approvals from the European Commission (**EU**) on 17 September 2015, as well as from the Korean Fair Trade Commission (**KFTC**) on 23 November 2015. The remedy submitted to MOFCOM by NXP is quite similar to that submitted to the EU and KFTC. This is, to a large extent, due to the fact that the geographical markets of the relevant products, which drew the attention of anti-monopoly authorities in different jurisdictions, are defined as the global market. This also indicates that MOFCOM's anti-monopoly review and law enforcement

¹Michael (Zhengping) Gu is a founding partner of AnJie Law Firm based in Beijing. Michael specializes in competition law and M&A. Michael can be reached by michaelgu@anjielaw.com or telephone at (8610) 8567 5959.

practices are becoming more in line with international practice.

Conditional approval after re-filing

This case saw the re-filing of the merger notification after withdrawal of the first filing. MOFCOM initially received the Freescale/NXP merger filing on 3 April 2015. However, it deemed the filing incomplete and requested that the parties submit supplementary material. MOFCOM filed the case and initiated a preliminary review on 15 May 2015. On 11 September 2015, with the agreement of NXP, MOFCOM extended the period of review. When the extension period was coming to its end, NXP requested withdrawal of the filing. On 10 November 2015, MOFCOM initiated a fresh review for the parties' re-filing. Unlike other cases that were also conditionally approved after re-filing, this case was quickly approved. MOFCOM made the decision on 27 November 2015, only 17 days after the re-filing. From the date the parties first submitted the notification to MOFCOM to the date when MOFCOM published the conditional approval, the review process took a total of 236 days. Nevertheless, the actual review period is 192 days if counting from the date that the case was filed by MOFCOM for the first time.

MOFCOM has conditionally approved 26 cases since the implementation of the *Anti-Monopoly Law*, of which many cases involve re-filing after withdrawal of filing. MOFCOM announcements generally do not disclose the reasons for withdrawal (e.g. *Glencore/Xstrata* case, *Marubeni/Gavilon* case, *Media Tek/MStar Semiconductor* case). However, in *Western Digital/ Hitachi* case, MOFCOM disclosed the reason for withdrawal of the case. The reason was that there were significant changes of the facts of the case. To our understanding, the main reason for withdrawal in most cases is that it is a way for the notifying parties to buy time to negotiate remedies with MOFCOM. In some complex cases, notifying parties may voluntarily withdraw the case if they cannot propose remedial measures to relieve MOFCOM's competition concerns within the time limit prescribed by law. By taking such a step, they win more time to communicate with MOFCOM to avoid the transaction being banned and to increase the possibility of obtaining clearance.

The relevant market

In this case, NXP and Freescale have horizontal overlaps in the general microcontroller, automotive power-use analog ICs and RF power transistor product markets. When defining the relevant product market, MOFCOM made a detailed division of the analog ICs market by differentiating general analog ICs from special analog ICs. The products involved in this case are special analog ICs used for the automobile industry. MOFCOM further divided special analog ICs into power-use special analog ICs and non power-use special analog ICs based on their different functions. Since they have different

functions, IP modules and production technologies, MOFCOM held that automotive power-use analog ICs constituted an independent product market.

Defining the relevant market is crucial to competition analysis. According to the *Guidelines on the Definition of a Relevant Market* promulgated by the Anti-Monopoly Commission of the State Council, scientific and rational definition of the relevant market plays an important role in critical issues, such as identifying existing and potential competitors, determining the market share of a business operator and the market concentration ratio and determining the market position of a business operator, etc. Defining the relevant market is generally the starting point for the analysis of a competition conduct. When defining the relevant product market, the factors to be taken into account may include the product's characteristics, price, intended use, consumer preference and substitutability of demand and supply. As the relevant product market is further subdivided, the scope of inspection will be narrower and the notifying parties will be regarded as having greater influence on the market due to the increase in market shares. This is more likely to attract the attention of anti-monopoly authorities. In this case, MOFCOM defined the relevant product market as the automotive power-use analog ICs market, indicating that MOFCOM is inclined to make narrow subdivisions when defining product markets.

To ascertain the relevant geographical market, MOFCOM conducted its analysis by looking at various aspects, including regulatory barriers to trade, transportation costs, supply and procurement scope, etc. The relevant geographical markets of general microcontroller, automotive power-use analog ICs and RF power transistor were defined as global markets by MOFCOM on the following grounds: there are no regulatory barriers to the trading of the relevant products; transportation costs account for a low percentage of the total market price; the manufacture, procurement and supply of the products take place across the globe; and suppliers have to compete on a global scale.

MOFCOM focuses its review on market shares

In this case, by taking into account the parties' market shares and control capability, the degree of concentration in the relevant market and the market entry difficulty level, MOFCOM established that the proposed deal could eliminate or restrict competition in RF power transistor product market. According to the *Interim Provisions on the Assessment of Impact of Concentration of Undertakings on Competition* published by MOFCOM, market share plays a significant role in the analysis of the structure of the relevant market and in the determination of the position of the undertakings and their competitors in the relevant market. After analysis, MOFCOM found that RF power transistor product market features few competitors and high concentration levels. The top eight market players account for around 90% of the market, and NXP and Freescale's market shares are number one and two in the global market, with a combined market share of 54% in 2014.

The merger of the undertakings in this case will remove competition between the top two market players, thus garnering the close attention of MOFCOM. There are similar preceding cases in which the mergers of parties with top-ranked market shares had been conditionally approved, on the condition that structural remedies of divesting relevant business be adopted. In *Panasonic/Sanyo* case, the notifying parties were the largest and second largest manufacturers in the highly concentrated button-type rechargeable lithium battery market. The merger between the parties would result in Panasonic holding 61.6% market share. In light of this, MOFCOM requested that the notifying parties fully divest Sanyo's existing button-type rechargeable lithium battery business within six months of obtaining conditional clearance from MOFCOM; In *Goodrich/United Technologies* case, the notifying parties were the two biggest market players in the aircraft AC power systems market. MOFCOM thus requested that United Technologies divest Goodrich's power systems business within 6 months of obtaining conditional clearance from MOFCOM. In addition, in *Maersk/Mediterranean Shipping/CMA CGM*, a case regarding the establishment of a Network Center, the capacity shares of the transaction parties are top three in the Asia-Europe route. As the integration would significantly enhance the parties' market power, MOFCOM decided to prohibit this concentration of undertakings.

The main reason MOFCOM focused on the market shares of the two parties is due to the fact that the boost of market shares from the concentration may give rise to a series of competition issues. NXP and Freescale are the top two competitors in the RF power transistor product market with similar process technologies and similar pool of clients that tend to procure products from both companies. The two players have competed fiercely and created competition constraints for each other in the relevant market. The proposed deal will thus eliminate the intense competition between the two market players, reduce options for clients and increase procurement risks. MOFCOM therefore considered that the proposed deal has the potential to eliminate or restrict competition in the RF power transistor product market.

Remedial Measures

In accordance with MOFCOM's decision, NXP shall follow its written commitment submitted to MOFCOM and completely divest its RF power transistor business to Beijing Jianguang Asset Management. At the same time, NXP shall strictly fulfill its obligations during the transition period. It is worth noting that the NXP/Freescale deal shall only be implemented after the divestment deal has been concluded.

This is the first case in which MOFCOM adopted a structural remedy of divesting business to counter potential negative effects on competition since the implementation of the *Provisions on Imposing*

Restrictive Conditions on the Concentration of Undertakings (Trial Version) (“**Provisions on Imposing Restrictive Conditions**”) on 5 January 2015. In the Provisions on Imposing Restrictive Conditions, MOFCOM made detailed provisions for the determination, fulfillment, supervision, change and termination of restrictive conditions. Article 20 of the Provisions on Imposing Restrictive Conditions emphasizes that the responsibility of divestment obligors is to ensure the viability, competitiveness and marketability of the divested business. In addition to aforesaid concerns, MOFCOM focused on the scope and effect of the divested business, the suitability of potential buyers and the attitude of downstream buyers towards the remedies. These assessment points in MOFCOM’s announcement provide guidance and act as future reference to notifying parties who need to submit structural remedies.

In previous cases involving structural remedies, divestment obligors are usually required to find buyers and sign agreements for the divested businesses within a specified period of obtaining conditional clearance from MOFCOM. For instance, in *Wyeth/Pfizer* case, Pfizer was required to seek out and enter into an agreement with a buyer for the divested business within 6 months of obtaining conditional approval. Likewise, in *Goodrich/United Technologies* case, United Technologies was required to seek out and enter into an agreement with a buyer for the divested business within 6 months of obtaining conditional approval. This is partly due to the market efficiency considerations, as notifying parties request for quick approval, and partly out of consideration for the divestment obligors in not being able to find a buyer immediately.

Nevertheless, it seems that the obligations of NXP required by MOFCOM were stricter in this case. The most important reason for this is that, NXP proposed a structural remedy to MOFCOM, including divestment of its RF power transistor product operations to Beijing Jianguang Asset Management, during the early stages of the review of the second notification. Since NXP had already found and entered into an agreement with a buyer for the divested business, it was not necessary for MOFCOM to grant extra time to NXP for the purpose of seeking a buyer.

In addition, MOFCOM requires NXP to perform relevant obligations during the transition period from the date of approval announcement till the divestment deal has been concluded. NXP shall endeavor:

1. not to engage in any ‘unfair trade practices’ relating to the divested business;
2. not to implement any acts which may have significant adverse impact on the value, management or competitiveness of the divested business, or any acts which may change the nature and scope, industry or business strategy or investment policy of the divested business, and to take reasonable measures to encourage core employees to stay in the divested business, as well as not to seek or transfer employees to NXP’s non-divested business;
3. to ensure supply to the divested business in a fair, reasonable and non-discriminatory manner; and

4. to maintain the independence of the divested business, and not to exchange competitively sensitive information between the parties and the divested business.

Conclusion

In this case, MOFCOM made a conditional approval, similar to the decisions made by the EC and KFTC. Also consistent with the approaches by the EC and KFTC, MOFCOM defined the relevant geographical market as the global market. MOFCOM did not conduct a separate analysis of the impact the acquisition on the Chinese market. MOFCOM mainly focused on analyzing the market shares of Freescale and NXP in the RF power transistor market. In terms of market definition, competitive analysis and structural remedies, MOFCOM's approach to the enforcement of anti-monopoly law is becoming more convergent to that of EC and KFTC.

As the first case approved with structural remedies after the enactment of the Provisions on Imposing Restrictive Conditions, MOFCOM's evaluation of the viability, competitiveness and marketability of the divested business, as well as the suitability of potential buyers, in this case sets a referential precedent for filing parties who may be required to submit structural remedies in the future.

In addition, this case went through the re-filing process after withdrawal of the first filing. The notifying parties withdrew the case near the expiration of the further review period in order to gain more time to discuss effective remedies with MOFCOM. In complex concentrations involving sensitive competition issues, withdrawing and re-filing can be adopted as a flexible strategy to avoid the deal being prohibited by MOFCOM.