

Huiyuan's Acquisition by Coca-Cola in PRC – Case Analysis

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Abstract—It can be illustrated by the case of the acquisition of Huiyuan Group by Coca-Cola Company that the Chinese Anti-monopoly Law of the PRC is on the face not at all inferior to those of other jurisdictions subject to some uncertainties.

Index Terms—Chinese competition law, anti-monopoly law, Coca-Cola, Huiyuan, acquisition

I. INTRODUCTION

In 3 September 2008, the Coca-Cola Company announced that it had offered to buy the premier of the PRC domestic juice manufacturer, China Huiyuan Juice Group (Huiyuan), for US\$2.4 billions and has notified the Ministry of Commerce of the People's Republic of China (MOFCOM) in accordance with Articles 21 & 23 of the Chinese Anti-Monopoly Law (AML). After further submissions of supplementary documents and materials by the Coca-Cola Company, the MOFCOM has published a decision under Article 25 of the AML on 18 March 2009 to prohibit the Coca Cola Company from acquiring Huiyuan¹. The prohibition decision is the first prohibition decision issued by MOFCOM since the enforcement of the AML. It was heavily criticized that the decision was without basis and is based on policy rather than legal ground. Indeed, Article 27(6) of the AML states that MOFCOM may base on other factors identified by the authority as affecting competition. This provision leaves scope for the authority to give effect to policies other than the promotion of competition, such as the encouragement or discouragement of certain types of economic activity, or the promotion of investment into particular areas or restriction of foreign influence in particular market sectors. It was pointed out by Graeme Johnson [1]² that non-competition factors may prevail is made abundantly clear by the first sentence of Article 28 which, after requiring the authority to prohibit concentrations which “will or may” eliminate or restrict competition, goes on to give the authority discretion not to do so if it considers that the undertakings concerned have demonstrated that there are other public interest reasons to allow the concentration

Although the MOFCOM's decision on the Coca-Cola – Huiyuan barely gave any detailed explanation on the method

of analysis and the basis on which the decision was based on, this paper serves to demonstrate that the decision may not be based on policy grounds but by competition theories.

II. THE IDENTIFICATION OF THE RELEVANT MARKET

Unlike decisions in other jurisdictions such as common laws or EU countries, the decision is a two pages document which sets out the conclusion of the MOFCOM's findings without giving detailed explanations [2]³. Nevertheless, the decision has identified that the relevant market is the fruit juice market. Notably, in the case, the decision does not describe how MOFCOM defined the relevant market or discuss the market shares of the parties or their competitors or whether the parties are close competitors. This point has been heavily criticized by professionals [3]⁴ and academics [4]⁵.

Article 12 of the AML has defined the relevant market as 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. This definition is similar to those of other jurisdictions such as U.S. except that time element is added.

In an attempt to provide clarification of the final decision, MOFCOM spokesman, Yao Jian, in an interview in the *People's Daily*, tried to flesh out the Ministry's rationale for rejecting the bid. He explained that there were two ways to define the relevant market. The first was substitutability of demand from a consumers' perspective. In general, if consumers were more likely to buy B as a substitute of A, then competition existed between B and A: both belong to the same relevant market. The other way was substitutability of supply, from the suppliers' perspective. If suppliers of B could easily offer a closely-related product to A with little extra risk, then B and A belonged to the same relevant market [5]⁶. Yao addressed that there were two sub-sectors under the non-alcoholic beverage sector. These were the juice beverages and carbonated soft drinks sectors. The relevant market in this case was the juice beverage market. However, he did not explain on how MOFCOM came to such a

³ Vanessa Yanhua Zhang & Howard Hao Chang, *The InBev and Anheuser-Busch Merger in China: A View from Economists*, Global Competition Pol'y Mag. December 2008

⁴ Mathew Bachrack, Cunzhen Huang and Jay Modrall, “Merger Control under China's Antimonopoly Law: The First Year”, chinabusinessreview.com July-August 2009, pp. 22.

⁵ Zhang, Xinzhu; Zhang, Vanessa Yanhua (2010) *Chinese Merger Control: Patterns and Implication*, Journal of Competition Law and Economics 6(2), pp. 477

⁶ Zhan Hao Coca-Cola and Huiyuan: Explanation, theory, an attempt to rationalise? China Law and Practice May 2009.

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¹ Public Announcement No.22 of 2009 of the Ministry of Commerce – on Promulgating the Result of the Anti-monopoly Declaration for Concentration of Business Operators by the Coca-Cola Company of the United States and the China Yuiyuan Juice Group Limited.

² Graeme Johnson ed. *Competition Law in China and Hong Kong* (2009), Sweet and Maxwell, pp. 122.

conclusion[6]⁷.

In the Press Release, MOFCOM however made it clear that the relevant market was defined as the fruit juices market, consisting of 100% pure fruit juices, blend fruit juices with fruit contents of 26%-99%, and juices with fruit contents below 25%. Huiyuan is China's largest fruit juice manufacturer possessing market-share of 46% for pure juice, 39.8% for the juice with a concentration 26-99%, and 10.3% for juice with a concentration of less than 25%. MOFCOM claimed that it had conducted in-depth analysis of the substitutability between fruit juices and carbonated soft drinks and between fruit juices with varied concentrations of fruit. It made decision on the relevant market on the basis of (1) low substitutability between fruit juices and carbonated soft drinks and (2) very high substitutability of both demand and supply between fruit juices with different concentrations of fruit [7]⁸.

It seems clear that the "substitutability" principle played a major role in MOFCOM's decision to define the relevant market. MOFCOM seems to have adopted similar methodologies of market definition as those used in other more mature jurisdictions⁹.

This case drew people's attention to an important concept of anti-monopoly law: relevant market. Some did not agree with the relevant market MOFCOM defined in this case. It was thought to be too narrow and soft drink market may be more proper in this case. On the contrary, others argued that this definition is too broad and they prefer pure and middle-level juice beverage market.

From my point of view, the relevant market defined in this case is proper. The carbonated soft drinks and juice beverages are fundamentally different: they have different ingredients, tastes and functions, etc. Customers of one kind are not likely to transfer to another because of the characteristics of two beverages. Neither suppliers of one kind are likely to transfer to another because of the technical hurdle. According to the demand and supply substitution theory, they are not in the same relevant market. As to the juice beverage, no matter pure, middle-level concentration or low-level concentration, share some similar characteristics and possibility of substitutions exist among them. As a result, juice beverages are in the same relevant market.

After the decision on July 7 2009, the Anti-monopoly Commission of the State Council published a *Guidelines on the Definition of Relevant Market*¹⁰. These are the first guidelines adopted by the Anti-Monopoly Commission according to the AML. The Guidelines explicitly stress that there is no single method for defining the relevant market. The basic method for defining the relevant market is the substitution analysis both from the demand-side, and from

the supply-side where the case requires. Where the market scope is not clear or is not easy to define, the Hypothetical Monopolist Test, known as the SSNIP (Small but Significant and Non-transitory Increase in Price) test, may be applied. This test has long been a routine part of US and EU antitrust practice in defining the relevant market.

In the Coca-Cola/Huiyuan case, the MOFCOM spokesman stressed that in the review process it had adopted the method of demand substitutability and supply substitutability to define the relevant product market. Adhering to the economic analysis and based on the evidence from collection and market investigation, MOFCOM held that the carbonated soft drinks market and fruit juice beverage market are separate product markets and the relevant product market applicable in that transaction was the latter market.

The MOFCOM decision proceeds on the basis that Coca-Cola has a dominant position in the Chinese carbonated drinks market, but does not state how it reached this conclusion. Article 19 of the AML provides for presumptions of dominance based on single-firm market shares or combined market shares of the two or three largest firms in a market, MOFCOM's announcement did not indicate whether it relied on any of these presumptions or what market share was attributed to Coca-Cola. Even if subject to such a presumption, the AML recognizes factors that may rebut such a presumption, including whether a company has the power to control pricing or competition in the relevant market. The MOFCOM statement did not include any finding that Coca-Cola has such power, a proposition that seems debatable given the presence of other competitors [8]¹¹.

According to data collected by AC-Nielsen in 2007, the largest 4 manufacturers in Chinese fruit juice beverage market are named Uni-President, Cola-cola (Meizhiyuan), Huiyuan and Tinghsin with market share of 21%, 20%, 15% and 16% respectively. That means that if Coca Cola acquired Huiyuan, its share in the fruit juice beverage market would be increased from 20% to 35%, which does not exceed the 50% threshold of the EC horizontal merger guideline [9]¹² and may in itself be evidence of the existence of a dominant market position. However, the guideline also states that smaller competitors may act as a sufficient constraining influence if, for example, they have the ability and incentive to increase their supplies. A merger involving a firm whose market share will remain below 50% after the merger may also raise competition concerns in view of other factors such as the strength and number of competitors, the presence of capacity constraints or the extent to which the products of the merging parties are close substitutes. It is no doubt that the international beverage giant - Coca cola which holds 60.6% of the carbonate drink market, together with the local leading fruit juice producer have the strength to dominate the fruit market.

⁷ Zhang Angela Huyue, (2013) *Toward an Economic Approach to Agency Agreements*. Journal of Competition Law and Economics 9(3), p.553

⁸ Jonathan Selvadouray, George Ji and Elaine Zhu, China: Coca-Cola's Acquisition Of Huiyuan, A Lost Opportunity For MOFCOM.

⁹ In the U. S. landmark Brown Shoe's case (Brown Shoe Co. Inc v United States 370 U.S. 294 at p.325), Chief Justice Warren has defined that the relevant market is related to product market (the "line of commerce") and the outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it.

¹⁰ http://www.brics2011.org.cn/english/jzlt_en/jzfg_en/201107/t20110726_111645.html.

¹¹ Peter J. Wang H. Stephen Harris & Mark Allen Cohen *Coca-Cola / Huiyuan Deal is First Acquisition Blocked by China Antitrust Review* http://www.martindale.com/antitrust-trade-regulation-law/article_Jones-Da_y_661002.htm view on 2.10.2009.

¹² *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (2004/C 31/03), Official Journal of the European Union 5.2.2004, C 31/7.

III. THE IDENTIFICATION OF THE MARKET CONCENTRATION RATE OF THE RELEVANT MARKET

Article 27(2) of AML requires that the degree of market concentration in the relevant market be taken into account in the examination of the concentration of business operators. The method of determination of the market concentration rate is not stated in the AML provisions nor is there any guideline to clarify the method. According to the U.S.'s Horizontal Merger Guidelines [10]¹³, the Herfindahl-Hirschman Index (HHI) is used to measure both the pre and post merger market concentration [11]¹⁴. The HHI is calculated by summing the squares of the individual market shares of all market participants. According the Guideline, an HHI score below 1,000 is non-concentrated, between 1,000 and 1,800 is moderately concentrated, and above 1,800 is concentrated with 10,000 being a monopoly. The post-merger standards are largely the same except that incremental criteria are added. Below 1000 denotes a non-concentrated market that requires no further analysis. HHI in the range of 1000 and 1800 denotes a moderately concentrate market in which an increase of 100 or less requires no further analysis but an increase of more than 100 raise significant competitive concerns. Over 1800 denotes a highly concentrated market in which an increase of over 50 HHI score falls within the "potential significant concern" category, and over 100 creates a presumption of market power. For HHI which is "potential significant concern" additional factors set out in the Guidelines should be considered. Similar to the U.S. guideline, EC's horizontal merger guideline¹⁵ also divides the markets into categories of non-concentrated, moderately concentrated and highly concentrated markets with HHI of 1000, between 1000 & 2000, and over 2000 respectively as criteria.

In the decision of the Coca-Cola case, MOFCOM merely stated that it has considered the market concentration rate of the relevant market but never disclose the method or the actual assessment. However, according to AC Nielsen¹⁶, the largest 4 manufacturers in Chinese fruit juice beverage market are named Uni-President, Cola-cola's existing brand Meizhiyuan (Minute Maid), Huiyuan and Tinghsin, their market share are 21%, 20%, 15%, and 16% respectively. Assuming that the rest of the market share of 28% be shared equally between 7 manufacturers (4% @ 7 = 28%).

The estimated HHI before the merger is therefore

$$21^2 + 20^2 + 15^2 + 16^2 + 7 \times 4^2 = 1210 \quad (1)$$

The market share of Coca-Cola after acquisition is

$$20 + 15 = 35 \% \quad (2)$$

The estimated HHI after the merger is therefore

$$21^2 + 35^2 + 16^2 + 7 \times 4^2 = 2034 \quad (3)$$

with the change in HHI = 824.

From the assessment, it can be seen that before the acquisition, the juice market is a moderate concentrated market (HHI between 1,000 and 2,000) according to the definition of U.S. and EC guidelines. After the acquisition, the juice market becomes highly concentrated and the significant change in HHI makes its presumption of market power. Therefore, it can be concluded by the HHI test that the Coca-Cola do gain market power control by the acquisition of Huiyuan and a horizontal competition concern is identified.

IV. WOULD COCA-COLA COMPANY GAIN THE ABILITY TO LEVERAGE A DOMINANT POSITION IN THE CARBONATED BEVERAGE MARKET OVER THE FRUIT JUICE MARKET

In the decision, MOFCOM considered that the Coca-Cola Company will gain the ability to leverage a dominant position in the carbonated beverage market over the fruit juice market after the completion of the Concentration, which causes the effect of eliminating or restricting competition on the existing fruit juice beverage producers and then will infringe upon the legitimate rights and interests of beverage consumers. It is also not clear what basis MOFCOM had for concluding that Coca-Cola could leverage its position in the carbonated beverage drinks market to increase its sales in the juice beverages market, whether through tying or bundling arrangements or the imposition of other restrictive conditions, leading to fewer options and higher prices for consumers. MOFCOM provided no basis for these fears in its decision, and did not state whether it had considered imposing conditions prohibiting such conduct. MOFCOM has stated that two sub-sectors under the non-alcoholic beverage sector are present: juice beverages and carbonated beverage drinks. Although the relevant market in this case is the juice beverage market, these two markets are closely related to each other. MOFCOM further stated that Coca-Cola already had market dominance in the carbonated beverage drinks sector and after the merger, Coca-cola will be able to transfer its dominant market position to the juice beverage market. This theory is not well-accepted and there are still a lot of debates about it. This theory itself is not so persuasive in anti-monopoly practice. Besides, MOFCOM' conclusion did not be fully supported by the facts and its reasoning: MOFCOM did not explain and present evidence to illustrate how this transfer happens. This absence is one of the reasons for the lack of persuasiveness in the judgment [12]¹⁷.

However, MOFCOM's approach is not alone. It is very similar to the Australian Competition and Consumer Commission's 2003 decision [13]¹⁸ to oppose the acquisition

¹³ Jointed issued by the Department of Justice and the Federal Trade Commission in 1992 as amended in 1997.

¹⁴ S. 1.5, 1.51, Concentration and Market Shares, General Standards. Horizontal Merger Guidelines.

¹⁵ Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03), Official Journal of the European Union 5.2.2004, C 31/5.

¹⁶ The data was collected by Dr. Xiaoye Wang from AC Nielson 2007 viewed at http://www.asiancompetitionforum.org/090526_Hanoi/Presentations/09_Xi_aoye_Wang.pdf

¹⁷ O. N. Antoine and J. Z. Zhou (May 14 2009). Chinese Antitrust Enforcement Evolves Taking stock nine months after the anti-monopoly law became effective. *New York Law Journal*, Available: http://www.law.com/jsp/article.jsp?id=1202430678287&Chinese_Antitrust_Enforcement_Evolves viewed on 29.10.2009

¹⁸ Australian Competition and Consumer Commission, ACCC Assessment of Coca-Cola Amatil Limited's Proposed Acquisition of Berri Limited (Nov. 25 2003), available at <http://www.accc.gov.au/content/item.php?itemld=503214&nodeld=933cf0f7f72fc1bbe102c39b6243b815&fn-Coca-Cola%20Amatil%20Ltd's%20pr>

of Berri Limited by Coca-Cola Amatil (CCA), the Australian Coca-Cola bottler and partly-owned affiliate of the Coca-Cola Company. In that case, the ACCC's conclusions were that:

- CCA would have several means by which it could bundle, tie or otherwise link sales of Berri products to CCA's leading portfolio of carbonated soft drink products.
- there would be significant cost savings and efficiencies arising from this merger, both for Coca-Cola and its non-grocery retailers including reduced logistics costs, which would increase the incentive for bundling to occur; and
- it was likely that, as a result of such bundling, a number of competitors would be likely to exit the fruit juice and fruit drink market, as those competitors would be faced with reduced revenues and increased unit costs post-merger.

In the Berri case, the ACCC rejected various "behavioral" remedies proposed by CCA, on the basis that these could not fully address the long-term competition harm arising from the proposed transaction. In particular:

- It would be difficult to frame the undertakings so that they captured all potential conduct that would have the effect of linking Berri's fruit juice products to Coca-Cola soft drink products; and
- Behavioral undertakings could not adequately address the incentive for retailers to themselves seek to acquire fruit juice and carbonated soft drink products from Coca-Cola on a bundled basis.

It is not clear whether Coca-Cola proposed similar undertakings to the Chinese MOFCOM in that Huiyuan case. However, it appears unlikely that behavioral undertakings of this kind would have been sufficient to satisfy the Ministry's concerns.

MOFCOM's decision shows it will give careful consideration to competition issues arising from merger proposals under the AML, and will be willing to block any such proposals where significant competition concerns arise [14]¹⁹.

The MOFCOM notice cannot clearly demonstrate that the theory was appropriately applied in these circumstances. The ACCC devote five pages of its Berri assessment to a detailed 'competition analysis' considering the distinctive distribution channels for carbonated soft drinks and fruit beverages, the dynamics and structure of Australian market, the growth of Coke's 'Fruitopia' fruit beverage brand, and evidence that bundling (and customer-side bundling) was already occurring in the market. The MOFCOM notice, in contrast, offer barely five sentences of analysis [15]²⁰.

19 David Ball and Michael Corrigan, "China: Juice And Coke Do Not Mix: Chinese Ministry Blocks Coca-Cola's Chinese Juice Acquisition", 01 May 2009, <http://www.mondaq.com/article.asp?articleid=79010> viewed on 13.10.2009

20 Oracle Bones, "Limited Lessons from China's Merger Rulings" the Antitrust Source, August 2009. <http://www.antitrustsource.com>.

V. CONCLUSION

Although the Coca Cola Huiyuan case is a typical Chinese judgment that does not give detailed explanation, it is demonstrated that the general features of the PRC's AML merger control system are on the face not at all inferior to those of other jurisdictions. Nevertheless, there exist plenty of uncertainties, such as

- Whether the substantive principles applied by MOFCOM will be publicly articulated in more detail.
- Whether MOFCOM will develop and demonstrate a rigorous process to ensure these principles are applied objectively and neutrally.
- Whether economic analysis of the effect of a transaction on competition is predominate over other factors such as policy or security.
- Whether the quality of the underlying analysis by MOFCOM is up to international standard.

Although the detail analysis of the case was not published, it is demonstrated that the merging of the two companies may bring about a market power in the fruit juice market.

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