

## **China Law Could Impede Microsoft Deal for Yahoo**

*John Markoff*

Microsoft's hostile-takeover attempt against Yahoo may encounter an unexpected hurdle in August after a Chinese antimonopoly law takes effect that will extend the nation's economic influence far beyond its borders.

The law, which goes into effect on Aug. 1, is intended to strengthen an existing set of antitrust regulations the Chinese originally established in 1993. It will make China a third sphere of regulatory influence, matching the power of the European Union and the United States, according to legal specialists in this country and in China who have studied it.

Formally enacted by the National People's Congress last year, the measure gives Chinese regulators authority to examine foreign mergers when they involve acquisitions of Chinese companies or foreign businesses investing in Chinese companies' operations. Beijing could also consider national security issues, according to a report by the official news agency Xinhua.

The law could give China influence in Microsoft's courtship of Yahoo because in August 2005, Yahoo, a premier search portal, invested \$1 billion in Alibaba.com, China's largest e-commerce business. The investment gave Yahoo about a 40 percent stake in the Chinese company. Alibaba officials have said they believe that a Microsoft takeover of Yahoo would set in motion a buyback provision, making it possible for them to gain independence from Microsoft.

Nathan G. Bush, an antitrust law specialist with O'Melveny & Myers in Beijing, said the law represented the ascendance of China "as another regulatory capital contending for influence with Brussels and Washington."

"Multinational corporations will need to develop strategies for all the markets they operate in," he added, "and China is a big market."

Whether China would seek to review a Microsoft acquisition, and what kind of posture it might take, would be closely watched by regulators and global companies as an indication whether it will play a conciliatory or a nationalistic role on the world stage.

"I don't think anyone has worked through the issue of where an Internet merger should be reviewed, given that it truly is a World Wide Web," said Andrew I. Gavil, a law professor at Howard University.

There are potentially dozens of jurisdictions that could claim oversight in such a deal because of the global business interests of the two huge companies and because it could potentially transform the Internet into two megaportals, Google and Microsoft. Other parts of the world that might have an active interest in the outcome of a merger include South Korea, a vibrant Internet economy where an antitrust investigation into Microsoft was previously opened.

Executives at Microsoft and Yahoo declined to comment on the possible effect of the new Chinese law. In rejecting Microsoft's takeover bid in January, Yahoo's chief executive, Jerry Yang, said in a letter to employees that the offer substantially undervalued the company, in part because of the significant growth potential of the Alibaba business in China.

The issue of whether the Beijing authorities will harmonize the law with foreign antitrust laws or use it to fire a shot across the bow of global businesses was sharpened last week after an effort by Huawei Technologies to invest in 3Com collapsed in the face of national security concerns in Washington.

The Committee on Foreign Investment in the United States had examined the purchase, through which Huawei would have gained a stake in 3Com. The American company's Tipping Point subsidiary makes Internet intrusion-detection software, a technology that the United States maintains has national security implications.

Before the attempted investment fell apart, senior Chinese officials were quoted as saying they thought that the deal did not have national security implications, and that American regulatory efforts were a cover for protectionist trade practices.

National security has played a role in other attempted deals involving Chinese companies. In 2005, the Chinese National Offshore Oil Corporation made a high bid to acquire Unocal, leading to a vote in the House of Representatives to block the deal. Soon afterward, the Chinese company, known as Cnooc, withdrew its bid and Unocal was acquired by Chevron.

In the case of the proposed Microsoft-Yahoo transaction, the Chinese have in recent years become more and more alert to the role the Internet plays in their economic and political affairs.

Last week, a vice minister in the State Council Information Office, which oversees the Internet, said there were 230 million Chinese users of the Internet. He said the Internet sector accounted for 7 percent of the country's gross domestic product, and he expected that to rise to 15 percent in three to four years, according to a Reuters report.

The official, Cai Mingzhao, warned that foreigners should not use the Internet to interfere in Chinese internal matters, according to a report in The Guardian.

Even if the Chinese government did not try to prevent a takeover by Microsoft, a prolonged review could substantially damage the value of the business, a number of Internet industry executives said.

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