CHINESE COMPETITION LAW UPDATE

China's Anti-Monopoly Law Enters into Force

Brussels
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The *Anti-Monopoly Law* ("AML"), the new competition law of the People's Republic of China ("PRC"), entered into force on August 1, 2008. It is a comprehensive and modern antitrust regime that is broadly similar to competition laws in the United States and the European Union. It nevertheless contains various ambiguities that will give the Chinese authorities wide discretion when enforcing its provisions. Early decisions of the Chinese agencies will be followed closely to determine how the law is being applied and whether it is being used to pursue objectives unrelated to competition law.

The AML applies to foreign and Chinese companies and regulates activity outside China that may have an effect on Chinese markets, as well as activity inside China. Among other things, it prohibits anti-competitive agreements among companies and abuses of dominant positions, each punishable by significant fines – between 1% and 10% of a company's annual turnover – and disgorgement of profits.

The AML also requires the notification of mergers and acquisitions involving companies with turnovers above certain thresholds. Reportable transactions cannot be completed until they have been approved by the relevant Chinese agency. Earlier today, the central government of the PRC published the *Rules on Notification of Concentrations by Business Operators* (the "M&A Regulation"), passed by the State Council of the PRC ("State Council") on August 1, 2008, which prescribe the turnover thresholds for notifying mergers. In particular, concentrations involving two or more companies that each have Chinese revenues above RMB400 million (about US$58.59 million) must be notified in China. In due course, the State Council is expected to issue further regulations and guidelines.

This memorandum summarizes the AML's primary procedural and substantive provisions and highlights areas in the AML that may be of concern to companies operating in China.

I. BACKGROUND AND KEY PROCEDURAL ASPECTS OF THE AML

The AML has been in development for over 13 years. The AML's stated objective is to "prevent and curb monopolistic conduct, protect fair market competition, enhance economic efficiency, maintain the consumer interests and the public interests, and promote the healthy development of socialist market economy."[1] The AML is expected to supplant the PRC's existing antitrust framework, which comprises an array of ambiguous and duplicative laws that are rarely enforced and that are administered by multiple government agencies.[2]

A. AGENCIES RESPONSIBLE FOR ENFORCING THE AML

The State Council, as mandated by Article 9 of the AML, established an Anti-monopoly Commission on August 1, 2008, as a unified enforcement agency to, among other things, formulate competition policies and anti-monopoly guidelines as well as to coordinate anti-monopoly law enforcement. Under the supervision of the Anti-monopoly Commission, according to an announcement made by the Chinese government on July 16, 2008, the agencies tasked with enforcing the existing competition laws will continue to be tasked with enforcement duties in their respective areas of expertise under the AML.

- MOFCOM will be responsible for the review of merger notifications.
- SAIC will be charged with enforcing the cartel, abuse of dominance, and abuse of administrative power provisions.
- NDRC will retain responsibility for administering investigations into illegal pricing practices.

How investigations will operate in practice is not clear as the delineation of responsibility between MOFCOM, SAIC and NDRC is not watertight and the interaction between the AML and various other laws touching on competition policy is yet to be determined. These problems are especially acute in relations to matters involving intellectual property. It is expected that the Anti-monopoly Commission will play an important role in organizing, coordinating and supervising the concurrent enforcement of the AML by the different agencies.

The PRC has directed considerable resources over the past several years to educating personnel within MOFCOM, SAIC and NDRC about competition law. Especially in the area of merger control, we expect these agencies to be in a good position to enforce the AML immediately.

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1 Art. 1.

2 These agencies include (i) the Anti-monopoly and Anti-unfair Competition Bureau under the State Administration of Industry and Commerce ("SAIC"), (ii) the Price Supervision and Inspection Division under the National Development and Reform Commission ("NDRC"), and (iii) the Anti-monopoly Investigation Office (to be replaced by the Anti-monopoly Bureau) under the Ministry of Commerce ("MOFCOM").

B. SCOPE OF THE AML

The prohibitions contained in the AML apply to activities outside China if these activities are deemed "to eliminate or ha[ve] a restrictive effect on competition in the domestic market of the PRC,"[3] as well as to activity in China. The provisions of the AML apply to Chinese and foreign companies, as well as to certain actions of government agencies. Article 7, however, appears to carve out an exception for industries that are state-controlled and "concern the lifeline of the national economy and national security," as well as government-sanctioned monopolies. Companies operating in these industries are subject instead to an amorphous list of moral obligations not to harm consumers. It is not clear which agency would actually supervise these companies' conduct.[4]

C. PROCEDURAL POWERS OF THE AML ENFORCEMENT AGENCIES AND COMPANIES' PROCEDURAL RIGHTS

The AML gives MOFCOM, SAIC and NDRC significant power to investigate suspected antitrust violations. These agencies are empowered to conduct on-site inspections; interview individuals and organizations; review, copy, seal, and seize relevant documentary and material evidence; and examine the bank accounts of the undertakings concerned.[5]

The AML contains limited procedural protections for companies that are subject to investigation. Inspections by MOFCOM, SAIC or NDRC, as the case may be, must be conducted by officials in groups of two or more, and those officials are obliged to make written records of their findings that must be counter-signed by the parties subject to the inspection and interviewees.[6] They are also obliged to maintain the confidentiality of any commercial secrets that are disclosed during the course of an investigation.[7] Companies under investigation are permitted to submit statements and evidence in their defense.[8]

Where the Anti-monopoly Investigation Office (or in the future, the Anti-monopoly Bureau) under MOFCOM issues a decision prohibiting or imposing restrictions on a proposed concentration, the companies involved are entitled to ask MOFCOM to reconsider its decision. If the companies involved are not satisfied with the outcome of the reconsideration, they are entitled to sue MOFCOM to reverse the

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3 Art. 2.

4 Art. 7.

5 Art. 39.

6 Art. 40.

7 Art. 41.

8 Art. 43.

decision in Chinese court.[9] Where parties are not satisfied with any other decision of MOFCOM, SAID or NDRC, parties are entitled to either ask the agency to reconsider its decision or immediately bring an action in Chinese court to reverse the decision.

D. TRANSITION

The AML does not contain transitional provisions. It is not certain that the provisions of the AML cannot be used to prosecute or bring suits for anti-competitive practices that ceased before the AML entered into force, or that awards of damages or fines for anti-competitive conduct could not be based on conduct that occurred before the AML came into force. It is also not clear whether concentrations notified to MOFCOM under the prior rules will be evaluated under the pre-existing merger control regime.

Moreover, the AML does not expressly repeal the PRC's existing competition laws. Although practitioners generally do not expect MOFCOM, SAIC or NDRC to pursue concurrent investigations under both the AML and the older legislation, the older legislation remains available as a legal tool, if desired.

II. PRINCIPAL SUBSTANTIVE PROVISIONS

The substantive provisions of the AML are broadly consistent with competition laws in the United States and Europe. The AML prohibits "monopolistic conduct," which is defined to include anti-competitive agreements (so-called "monopoly agreements"), the abuse of dominant positions, and mergers that have or would have anticompetitive effects.[10] There are important differences, however, between the AML and other competition regimes. The AML contains numerous ambiguities that will permit the AML's enforcement authorities wide latitude to interpret the AML. The AML also contains provisions that may affect the ability of foreign companies doing business in China to freely utilize and protect their intellectual property.

A. PROHIBITION OF ANTI-COMPETITIVE MONOPOLY AGREEMENTS

Chapter II of the AML prohibits restrictive horizontal and vertical "monopoly agreements."[11] Trade associations are also prohibited from facilitating or organizing monopoly agreements.[12] In addition, NDRC is drafting implementing rules regulating "price-related monopoly," which are intended to replace the current "*Provisional Rules on the Prohibition of Price-related Monopolistic Conduct*" issued in November 2003.

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9 Art. 53.

10 Art. 3.

11 Art. 13.

12 Art. 16.

1. Horizontal Monopoly Agreements

Illegal horizontal monopoly agreements are defined to include price and output fixing arrangements, market allocation agreements, group boycotts, refusals to supply technology or equipment, agreements to restrict research and development on new technologies and products, and any other agreements that restrict or eliminate competition.[13]

2. Vertical Monopoly Agreements

Article 14 prohibits vertical agreements between companies that fix resale prices, set minimum resale prices, or that otherwise restrict competition.

3. Exemptions

The AML does not define any category of monopoly agreements that are illegal "*per se*." Article 15 exempts from sanction monopoly agreements that would otherwise be illegal where the parties prove that: (1) the purpose of the agreement is consistent with one or a number of listed objectives; (2) the agreement will not substantially restrict competition in the relevant market; and (3) the agreement will enable consumers to share in the benefits of the agreement. There is no requirement that parties seeking an exemption prove that the restrictive elements of their agreement are "indispensable" for the achievement of the sanctioned objective, as is the case under Article 81(3) of the EC Treaty. The absence of an indispensability requirement affords SAIC and NDRC considerable discretion to permit conduct that might otherwise be deemed illegal.

The list of objectives that a monopoly agreement must pursue in order to avoid sanction are:

- Improving technology or researching and developing new products.
- Upgrading product quality, reducing costs, improving efficiency, unifying product models and standards, or implementing specialization of workforce.
- Boosting operational efficiency and enhancing the competitiveness of small and medium-sized undertakings.
- Serving public interests such as conserving energy.
- Mitigating a severe decrease of sales or excessive overstock due to economic recession.

13 Art. 13.

- Protecting the enterprises' legitimate interests in international trade and foreign economic cooperation.

- Addressing other conditions provided by law and the State Council.

4. Enforcement, Civil Liability and Leniency

If SAIC or NDRC (as the case may be) decides that a company is a party to a monopoly agreement, the agency is required to order that the agreement and any other associated illegal activities cease. The agency is also required to confiscate all illegal gains of the participating companies arising from their illegal monopoly agreement and is required to fine such companies between 1% and 10% of their turnover in the previous year.[14] If the agreement has not yet been implemented, SAIC (or NDRC) is permitted to impose a fine of no more than RMB500,000. Trade associations that organize or facilitate a monopoly agreement may also be fined up to RMB500,000 and can have their operating licenses revoked in the case of severe violations.

Third parties that suffer damages as a result of illegal monopoly agreements are permitted to sue parties to those agreements through private actions in Chinese courts.[15]

The AML does not contain a formal leniency program. Where a company voluntarily reports its monopoly agreements with others to SAIC (or NDRC) and supplies "important" proof, however, the agency is permitted, at its discretion, to reduce or eliminate the punitive measures it is otherwise entitled or required to impose against the reporting company.[16]

B. PROHIBITION OF THE ABUSE OF DOMINANT MARKET POWER

Chapter III of the AML prohibits abusive practices by firms with dominant positions. Article 17 defines "dominant market position" as "a market position held by a party that can control the price or quantity of commodities or other transactional conditions in the relevant market, or can block or affect other parties' access to the relevant market." Although Chapter III is in many ways similar to Article 82 of the EC Treaty, the AML contains other unilateral conduct provisions that may prohibit a broader class of conduct than Article 82.

1. Definition of a Dominant Position

There are two ways under the AML to determine whether a company occupies a dominant position in a market. First, Article 18 contains six considerations that SAIC is

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[14] The AML does not specify whether the amount of the fine is based on worldwide or Chinese turnover, or some other measure.

[15] Art. 50.

[16] Art. 46.

entitled to take into account when assessing whether a company has a dominant position. These considerations are:

- The company's market share in light of the competitive dynamics of the affected market.
- The company's ability to control sales or access to raw materials.
- The company's financial strength and technical conditions.
- The extent to which other companies have to rely on such company in transactions.
- The significance of barriers to entry.
- Other "relevant" factors.

Second, Article 19 states that SAIC may presume market dominance based on a company's or companies' market share(s) alone. A single firm may be presumed to be dominant if its market share in the affected market exceeds 50%. Two firms may be presumed dominant if their combined market shares exceed 66.7% in the affected market. Three firms may be presumed dominant if their combined market shares exceed 75% in the affected market. The presumption of dominance is rebuttable. A safe harbor provision prevents SAIC from deeming firms to have a dominant position where those companies have a market share of less than 10%. "Affected market" is not defined in the AML and it remains to be seen how SAIC will interpret this important concept.

2. Abuse of Market Dominance

Article 17 provides a non-exhaustive list of practices that are prohibited and constitute an abuse of dominance under the AML:

- Selling at unfairly high prices or purchasing at unfairly low prices.
- Selling below cost.
- Refusing to deal.
- Exclusive dealing.
- Imposing "bonded sales" or other unreasonable trade terms.
- Price discrimination between parties of equal standing through price or other transactional conditions.
- Other actions to be added at the discretion of SAIC.

Depending on the nature of the abuse under investigation, a company may be able to avoid sanction if it is able to show that its abuse was for a "justifiable reason." The AML does not define what constitutes a "justifiable reason," and it is not clear whether justifications for abusive behavior existing under Chinese law are narrower or broader than under American or European law.

3. Intellectual Property

In addition to Chapter III, Article 55 of the AML provides that although the AML does not prevent companies from protecting their legitimate intellectual property rights, the AML can be used against companies that abuse their intellectual property rights in order to eliminate or restrict competition.

Article 55 is an ambiguous and highly unusual provision. It is not clear what type of licensing or litigation practices SAIC may consider to be abusive. It could, for example, find litigation against a Chinese company seeking an injunction preventing the Chinese company from practicing the foreign company's patent to be an effort to restrict or eliminate competition. Recent discussions with Chinese authorities suggest this may be more the exception than the rule, comparable to refusal to license cases in the European Union. Foreign companies with significant intellectual property portfolios should monitor developments associated with this provision very carefully.

4. Enforcement and Civil Liability

If SAIC or NDRC (as the case may be) decides that a company has abused its dominant position, the agency is required to order that the abusive practices cease, to confiscate all illegal gains resulting from the abusive practices, and to fine the company that has abused its dominant position an amount between 1% and 10% of its turnover in the previous year.[17]

Third parties that suffer damages as a result of another company's abuse of a dominant position are permitted to sue the dominant company through private actions in Chinese courts.[18]

C. REGULATION OF MERGERS AND ACQUISITIONS

Chapter IV of the AML puts in place China's first comprehensive merger control regime. As mandated by Article 21 of the AML, and as already noted, on August 1, 2008 the State Council passed the M&A Regulation, which specifies which transactions require notification to and approval from MOFCOM before closing. The M&A Regulation was published today. The M&A Regulation, together with the general

[17] Art. 47. The AML does not specify whether the amount of the fine is based on worldwide or Chinese turnover, or some other measure.

[18] Art. 50.

framework set forth in the AML, is expected to replace Section 5 (*Anti-monopoly Review*) of the existing *Regulation on the Mergers & Acquisitions of Domestic Enterprises by Foreign Investors* ("2006 Rules"), enacted by six Chinese government agencies (including MOFCOM) in 2006. The 2006 Rules, which were administered by MOFCOM but have not yet been repealed, were a stopgap measure intended to regulate foreign acquisitions of Chinese companies while the AML was still being prepared.

1. Application of Chinese merger control laws

Under the AML, all mergers, share or asset purchases, and other transactions that transfer the ability to exercise decisive influence over undertakings ("concentrations"), whether between Chinese or foreign companies, are potentially subject to merger review by the Chinese regulator,[19] provided that the parties meet certain notification thresholds.

The turnover thresholds specified in the M&A Regulation require parties to notify MOFCOM of a concentration in one of two scenarios:[20]

1. In the previous accounting year, the worldwide aggregate turnover of the parties to the concentration exceeded RMB10 billion (about US$1.46 billion), and at least two of those parties each have individual turnover in China in excess of RMB400 million (about US$58.59 million).

   or

2. In the previous accounting year, the aggregate turnover in China of the parties to the concentration exceeded RMB2 billion (about US$293 million), and at least two of those parties each have individual turnover in China in excess of RMB400 million.

However, MOFCOM is also entitled to investigate concentrations that do not meet the turnover thresholds but that might nonetheless result in an elimination or restriction of competition.[21] It is not clear what authority MOFCOM has to prohibit or place restrictions upon such concentrations, or if the parties to such transactions are obligated to provide information or a formal notification to MOFCOM.

Practitioners welcome the simplicity of these thresholds, which are a marked improvement over the ambiguous and confusing market share notification thresholds included in early drafts of the M&A Regulation.

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19 Art. 20.

20 Art. 3 of the M&A Regulation.

21 Art. 4 of the M&A Regulation.

2. Standstill Periods

Notification of concentrations that exceed the turnover thresholds is mandatory, and parties that implement concentrations without notifying and receiving approval will be in violation of Chinese law. Parties that fail to notify MOFCOM of a concentration, or that complete a concentration before the expiry of MOFCOM's period of review, could be required by MOFCOM to cease the proposed concentration, dispose of the shares, assets or operations purchased in the concentration within a specified timeframe, and are subject to fines up to RMB500,000.[22] In addition, parties that fail to notify concentrations can expect to encounter significant difficulties when attempting to obtain licenses and permits from other Chinese regulators.

Notifications submitted to MOFCOM will initially be examined for completeness. If a notification is declared incomplete, MOFCOM will provide a list of additional information to be provided within a specified time period.[23] Once a notification is complete, MOFCOM has 30 days to review the transaction and decide whether to initiate an in-depth investigation. MOFCOM is obligated to communicate its decision to the parties to the concentration in writing. If a no-action letter is issued, or if MOFCOM fails to take a decision within 30 days, the parties can legally complete their transaction.

If instead MOFCOM decides to launch an in-depth investigation, MOFCOM has a further 90 days to review the transaction, after which it is obligated to issue a decision in writing to clear or prohibit the transaction. If MOFCOM fails to make a decision within the 90 days, the parties can legally close their concentration. The 90-day review period can be extended by an additional 60 days if the parties agree to an extension, or MOFCOM can unilaterally extend the period by 60 days if it determines that the documents submitted by the notifying parties "are inaccurate or need further verification," or that the "relevant circumstances have significantly changed" since the time of the notification.

Previous drafts of the M&A Regulation provided for an abbreviated review period for transactions that "obviously will not result in the effect of eliminating or restricting competition." This fast-track procedure has not been incorporated into the final version of the M&A Regulation. It is not clear whether the review periods, expressed in days, refer to calendar or business days. Under the 2006 Rules, the term "days" was interpreted to mean business days. If the same interpretation is applied under the M&A Regulation, the initial review periods under the AML will be longer than those applicable under EU and U.S. law.

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22 Art. 48.

23 Art. 24.

3. Notification and Substantive Review

Unlike the European Union and the United States, which each have specified forms for the purposes of merger notifications (the Form CO and the Hart-Scott-Rodino form, respectively), the AML and the M&A Regulation do not specify the form upon which notifications must be made. The AML does provide a limited amount of guidance, however, specifying that a notification must contain the relevant transactional agreements, the notifying parties' audited financial reports, and a report on the effects that the concentration is likely to have on competition.[24] This list of documents is not exhaustive, and MOFCOM retains discretion to require the production of any further documents it considers necessary to its investigation. Under the 2006 Rules, MOFCOM has tended to require more and more information in notifications; there is no expectation among practitioners that MOFCOM will accept less detailed information under the AML.

MOFCOM is charged with reviewing the notification in order to determine whether a concentration "will or may eliminate or restrict market competition."[25] Information relevant to MOFCOM's review may include, among other things, the parties' market shares; existing concentration in the affected markets; the effect of the concentration on access to the affected market and the development of technology; the effect of the concentration on consumers and national economic development.[26] In addition, acquisitions of Chinese companies by foreign entities may be subject to additional scrutiny if the acquisition concerns Chinese national security.[27]

If MOFCOM determines that a notified concentration would harm competition, it is empowered to prohibit the transaction[28] or attach restrictive conditions.[29] The extent to which a concentration must restrict competition, or the level of probability that MOFCOM must establish that a concentration would restrict competition, before it can prohibit the transaction, are unclear. MOFCOM retains discretion to permit concentrations that would harm competition where the notifying parties show that the advantages of the concentration outweigh the disadvantages, or where the concentration "is in line with the public interest."[30] Whether pure private efficiency gains will be a sufficient basis upon which to clear a concentration that would otherwise be prohibited, and the meaning of "public interest" in Article 28, are unclear.

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24 Art. 23.

25 Art. 28.

26 Art. 27.

27 Art. 31.

28 Art. 28.

29 Art. 29.

30 Art. 28.

4. Civil Liability

Third parties that suffer damages as a result of a concentration that is in violation of the AML notification requirements are permitted to sue the parties to the concentration in private actions in Chinese courts.[31]

D. COMPETENT COURT OF JURISDICTION IN CIVIL LITIGATION

The AML creates a private cause of action for any third party that suffers damages as a result of illegal monopoly behavior. According to an article published on the official website of the PRC's central government on July 30, 2008, China's intellectual property courts have been officially designated by the People's Supreme Court of the PRC to act as the court of first instance to handle anti-monopoly civil cases.

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Questions and cases under Chinese competition law will continue to be managed from offices where we have Chinese-speaking lawyers and in cooperation with Chinese local counsel, since foreign law firms are not entitled to practice Chinese law in China. For additional information, please do not hesitate to contact Stephan Barthelmess, Brian Byrne, Christopher Cook, Maurits Dolmans, Francisco-Enrique González-Diaz, Nicholas Levy, James Modrall, Till Müller-Ibold, Robbert Snelders, Romano Subiotto, John Temple Lang, Dirk Vandermeersch, or Antoine Winckler of the Firm's Brussels office (+32 2 287 2000); Mario Siragusa or Giuseppe Scassellati-Sforzolini in Rome (+39 06 69 52 21); Dirk Schroeder or Romina Polley in Cologne (+49 221 800 400); François Brunet in Paris (+33 1 40 74 68 00); Shaun Goodman in London (+44 20 7614 2200) or Jeremy J. Calsyn in Washington (+1 202 974 1500).

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[31] Art. 50.

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