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SAIC Issues New Draft Rules under the Chinese Anti-Monopoly Law

The State Administration for Industry and Commerce ("SAIC"), which is responsible for enforcing the Chinese Anti-Monopoly Law (the "AML") with regard to non-price-related conduct, has published three draft substantive rules for public comment. These drafts deal with the application of the AML to restrictive agreements, abuses of dominant market positions and abuses of administrative power. Unfortunately, in a number of areas SAIC apparently responded to criticism of specific provisions in the prior draft rules by deleting the offending provisions, leaving SAIC with greater flexibility. As a result, it seems likely that the final rules will provide less guidance than multinational companies operating in China might have hoped and expected. In particular, SAIC's increased flexibility under its revised leniency program, and the resulting reduction of legal certainty, may make the program less effective in inducing violators to apply for leniency.

I. BACKGROUND

The Chinese AML entered into force on August 1, 2008. Authority to enforce the AML is divided among SAIC, the Ministry of Commerce ("MOFCOM") and the National Development and Reform Commission ("NDRC").[1] Unlike MOFCOM and NDRC, SAIC has not officially announced any enforcement actions under the AML, although an SAIC official has disclosed that SAIC has investigated a multi-national company for anti-competitive conduct[2] and is investigating another company.

SAIC, MOFCOM and NDRC have published a number of draft and final implementing rules and guidelines within their respective areas of responsibility. The draft rules SAIC published on May 25, 2010 regarding restrictive agreements and abuses of dominant market positions are revised versions of draft rules published for comment

[1] MOFCOM is mainly in charge of merger control review, as well as investigating antitrust conduct in international trade; NDRC is responsible for price-related restrictive agreements, abuses of dominant market positions, and abuses of administrative power; and SAIC is responsible for scrutinizing non-price-related restrictive agreements, abuses of dominant market positions, and abuses of administrative power.

[2] According to an SAIC official, the case was settled when the company agreed to monitor its own conduct and report to SAIC.

in April 2009.[3] The draft substantive rules regarding abuses of administrative power is the first draft of these rules published for comment.

Although SAIC invited comment on all three drafts, the draft rules on restrictive agreements and abuses of dominant market positions seem unlikely to change significantly, since SAIC conducted a thorough review of these rules following its first consultation in 2009. SAIC's revised rules are thus likely to be close to the final versions of these rules.

II. DRAFT RULES

The three draft rules published by SAIC are the following:

- Draft Rules of the Administrative Authority for Industry and Commerce on the Prohibition of Restrictive Agreements (the "Restrictive Agreements Rules");
- Draft Rules of the Administrative Authority for Industry and Commerce on the Prohibition of Abuse of Dominant Market Positions (the "Dominance Rules"); and
- Draft Rules of the Administrative Authority for Industry and Commerce on the Prohibition of Acts of Abuse of Administrative Power to Eliminate or Restrict Competition (the "Administrative Power Rules").

These draft rules are discussed below.

A. THE RESTRICTIVE AGREEMENTS RULES

The Restrictive Agreements Rules reflect substantive changes from the 2009 drafts in the following areas: (1) SAIC's proposed leniency program; (2) the definition of "concerted practice"; (3) types of prohibited restrictive agreements; and (4) possible sanctions.

1. Leniency Program

The Restrictive Agreements Rules substantially revise the leniency program proposed in the 2009 draft, deleting some of the most important elements of the program. In particular, leniency may be extended to an unlimited number of applicants, instead of only three, as provided in the 2009 draft.

[3] For a detailed review of the first drafts, please refer to our alert memo of June 18, 2009, which may be found at http://www.cgsh.com/saic_issues_rules_under_the_chinese_anti-monopoly_law/

In addition, the Restrictive Agreements Rules leave SAIC discretion in reducing penalties for the second and subsequent applicants, based on the time sequence of reporting, the importance of the information provided, relevant circumstances regarding the formation and implementation of the restrictive agreement and the level of cooperation provided (Article 13). By contrast, the 2009 draft provided for 50% and 30% reductions in penalties applied to the second and third applicants. SAIC appears to have done exactly the opposite of what many commentators recommended following publication of the 2009 drafts, which was to provide more detail on the operation of the leniency program. The revised program will likely be significantly less attractive to potential leniency applicants, both because the benefits of reporting a violation early will be less certain and because a violator can still hope to earn a reduction by cooperating even if it is not among the first three violators to report the violation.

On the other hand, the 2009 draft referred to reductions in "penalties" without specifying what types of penalties would be subject to the program. The Restrictive Agreements Rules specifies that the benefits of the leniency program apply only to monetary sanctions (Article 13) -- *i.e.*, confiscation of illegal gains and fines -- and thus not to a private action for damages or injunctive relief.

2. Definition of Concerted Practice

The Restrictive Agreements Rules provide that "restrictive agreements" include concerted practices. Compared to the 2009 draft, the Restrictive Agreement Rules add two new factors for SAIC to consider when determining whether practices are in fact "concerted." The new factors are "whether there has been communication of intent or an exchange of information among undertakings" and "the competitive landscape of the relevant market" (Article 3). Other factors mentioned in both drafts are consistency in the behavior of the relevant companies, the existence (or not) of legitimate reasons for consistent behavior, the structure of the relevant market, and market changes. Although the additional detail is welcome, the definition of concerted practices is still quite vague and could capture parallel conduct that does not result from any agreement.

3. Prohibited Restrictive Agreements

With regard to prohibited horizontal restrictive agreements, the Restrictive Agreements Rules provide additional detail regarding output restrictions (Article 4), market partition (Article 5) and restrictions on technology/equipment purchasing and development (Article 6). Article 4 provides that competitors' agreements to refuse to supply could constitute sales restrictions. Article 5 provides that agreements that divide sales volumes or the varieties or volumes of raw materials constitute market partition. Article 6 added a prohibition of competitors' agreements restricting the purchase or use of new processes or investments in or development of new processes or agreeing not to use new technology, processes or equipment or to adopt new technology standards.

The provisions regarding group boycotts (Article 7) are substantially unchanged, while provisions regarding bid rigging and conspiracies between auctioneers and bidders have been deleted. Bid rigging and conspiracies between auctioneers and bidders are not explicitly mentioned in the AML, but they are covered by two other Chinese laws, the Law on Invitation and Submission of Bids and the Anti-Unfair Competition Law. SAIC may have determined that bidding activities are price-related and should therefore be regulated by NDRC.

With respect to vertical agreements, the 2009 draft listed a number of different types of non-price related agreements that could be caught by the AML: agreements between auctioneers and bidders, vertical territorial restraints and vertical exclusive dealing. Perhaps in response to criticism of the 2009 draft, references to these categories of vertical agreements have been deleted. The Restrictive Agreements Rules (Article 8) now state that vertical restrictive agreements that harm consumers' interests, as well as "other" restrictive agreements as determined by the enforcement authorities, are prohibited. The Restrictive Agreements Rules thus leave SAIC greater flexibility to determine what vertical agreements might violate the AML and offer little guidance on SAIC's enforcement policy.

The rules regarding industry associations are largely unchanged, except that the Restrictive Agreements Rules explicitly prohibit industry associations from formulating or promulgating "standards" that eliminate or restrict competition (Article 10). The 2009 draft did not expressly reference industry standards.

4. Possible Sanctions

The AML provides that if a restrictive agreement has not been "implemented," violators may be fined not more than RMB 500,000. The Restrictive Agreements Rules add a provision that if a restrictive agreement has not been "reached," SAIC shall prohibit such conduct, but violators will apparently not be subject to any other sanctions (Article 11).

B. THE DOMINANCE RULES

The Dominance Rules revise the 2009 draft in the following areas: (1) SAIC's definition of a "dominant market position"; (2) SAIC's definition of "reasonable justification" for otherwise abusive conduct; and (3) provisions regarding specific abuses of dominant market positions.

1. Definition of a Dominant Market Position

The AML defines a "dominant market position" as a "market position in which an undertaking has the ability in the relevant market to control the price or quantity of products, or other transactional terms regarding products, or to impede or affect other

undertakings' ability to enter the relevant market." The Dominance Rules expand on the 2009 draft's definition of the "ability to impede or affect other undertakings' ability to enter the relevant market".

More specifically, Article 3 of the Dominance Rules provides that "[t]he ability to impede or affect other undertakings' ability to enter the relevant market" refers to "the ability to exclude other undertakings from entering the relevant market or to delay the entry of other undertakings into the relevant market in reasonable time, or *to increase* the costs of entry into the relevant market by other undertakings such that they can enter the market but *it is difficult* for them to effectively compete there" *(emphasis added)*." Under the 2009 draft, a company would be considered dominant only if it has the power "significantly" to increase other companies' costs of entry such that the other undertakings "cannot" effectively compete with existing competitors (instead of making it "more difficult" to compete). The broadened definition thus makes it easier for SAIC to find a company dominant.

The AML (Article 19) establishes a rebuttable, market-share-based presumption of dominance (*i.e.*, one company having a 50% share, two companies together having a 66% share and three companies together having a 75% share (except for any company having an individual share of less than 10%)). The Dominance Rules (Article 12) revise provisions with regard to rebutting a presumption of dominance. Under the 2009 draft, companies presumed to be dominant under these criteria would have to provide two types of evidence to rebut the presumption: (i) evidence that other companies can easily enter the relevant market and (ii) evidence that there is a reasonable degree of competition in the relevant market. In the case of presumed joint dominance, the companies in question would have been required to show that there is substantial competition between them and that no individual company possesses a "prominent market position" compared to the others. While providing less specific guidance, the Dominance Rules now seem to be more flexible in the type of evidence presumptively dominant companies may use to rebut the presumption.

2. Reasonable Justification

The AML and the Dominance Rules provide that a dominant company can defend conduct that might otherwise be characterized as abusive by providing a "reasonable justification." Neither the AML nor the 2009 draft define or give examples of a "reasonable justification."

The Dominance Rules offer general guidance in this regard (Article 8). SAIC will consider: (i) whether the behavior in question is conducted based on business customs, normal business operation and normal benefits; (ii) whether the behavior in question will result in eliminating or restricting competition and harming consumers' interests; and (iii) the behavior's impact on economic efficiency, social and public

interests and economic development. Importantly, the Dominance Rules do not define any "hard core" or *per se* prohibited categories of abusive conduct.

3. Abuse of Dominant Market Positions

The Dominance Rules revise provisions regarding practices prohibited by the AML as abuses of dominant market positions:

a. Refusals to deal and exclusive dealing

The Dominance Rules drop language from the 2009 draft stating that "refusing, reducing, restricting or terminating transactions with counterparties under the same trading conditions may be deemed to be without reasonable justification." This provision effectively made "discrimination" by a dominant company a *per se* offence. The change in the Dominance Rules thus subjects discrimination claims against a dominant company to a rule-of-reason test.

On the other hand, the Dominance Rules appear to make it easier for a non-dominant company to bring a claim under the "essential facilities" doctrine. Under the new draft, a dominant company may not deny other companies the use of necessary facilities on reasonable terms (Article 4). In assessing the reasonability of a refusal, SAIC should consider (i) the feasibility of investing in or developing the construction of alternative facilities; (ii) the reliance of the counterparty on the facility for the effective operation of its business; (iii) the possibility of providing access to the essential facility by the owner; and (iv) the impact on the owner's production and operation of providing access to the essential facility. Showing a violation under the new rules would seem to be easier than under the 2009 draft, under which a company refused access would need to prove that it "*cannot* conduct business operations without [access]" (*emphasis added*).

With regard to exclusive dealing, the Dominance Rules supplement the AML provision prohibiting a dominant company from restricting its counterparty to trading only with it or with a company designated by it without justifiable reasons by adding that a dominant company is prohibited from "requesting" counterparties not to deal with competitors (Article 5).

b. Tying and bundling

Under the 2009 draft, "bundled sales" were defined as sales conditioned on the counterparty's purchase of other products or a promise not to purchase from other companies; bundling sales of two or more products that can be sold separately; and charging a higher price for a product sold individually than for the same product sold in a bundle. The Dominance Rules largely replace the 2009 draft's definition and prohibition of "bundled sales" with the introduction of four situations in which products may be considered to be "bundled" (Article 6):

- Compulsory bundling or combining of different commodities contrary to transaction customs, consumption habits, or disregarding the functions of the commodities;
- Attaching unreasonable limits to the contract terms, payment method, transportation and delivery method of commodities or the service provision method;
- Attaching unreasonable limits to sales territories, sales targets and after-sale services; and
- Attaching conditions irrelevant to the object of the transaction.

c. Discriminatory terms

According to the 2009 draft, a dominant company would be prohibited, without justifiable reasons, from engaging in discriminatory treatment of counterparties in equivalent transactions with respect to transaction terms, such as the quantity and quality of goods or services, payment conditions, delivery methods, and after-sale services. The current draft provides slightly more detail on transaction terms that can be considered discriminatory, adding "discounts on quantity or other preferential terms" as examples of (Article 7).

On the other hand, the Dominance Rules provide less guidance on the meaning of "equivalent transactions." The 2009 draft defined "equivalent transactions" as "transactions conducted with respect to the same or similar commodities under the same or similar transaction conditions such as transaction volume during the same or similar time period." The Dominance Rules delete the definition.

C. THE ADMINISTRATIVE POWER RULES

The Administrative Power Rules are SAIC's first draft substantive rules dealing with abuses of administrative power. The relevant procedural rules, Procedural Rules of Administrative Authority for Industry and Commerce on Prohibition of Acts of Abuse of Administrative Power to Eliminate or Restrict Competition ("Administrative Power Procedural Rules"), took effect on July 1, 2009.

The AML prohibits the abuse of administrative power to eliminate or restrict competition. When such an abuse occurs, however, it is up to the superior authority of the authority accused of the violation to correct the situation. The anti-monopoly authorities may only propose remedial actions but cannot impose them.

As briefly touched upon in the Administrative Power Procedural Rules, the Administrative Power Rules (Article 5) restate that it is not an acceptable defense for an undertaking to argue that administrative authorities "compelled" or "disguisedly compelled" (*i.e.*, informally pressured) it to engage in anti-competitive conduct.

The Administrative Power Rules (Article 7) empower SAIC to "stop" anti-competitive behavior even if it is based on administrative "decisions," without explicitly mentioning other sanctions. If the undertakings in question continue their behavior after the governmental compulsion ends, then the sanctions imposed under the Restrictive Agreements Rules and the Dominance Rules will be towards the high end of the sanction range.

III. CONCLUSION

The Restrictive Agreements Rules and the Dominance Rules continue to reflect a form-based approach that attracted criticism when SAIC published its first draft substantive rules in 2009. Neither of the two Rules sufficiently stresses the need to show actual or likely anti-competitive effects of restrictive agreements or abusive practices to find an AML violation.

Similarly, the Restrictive Agreements Rules still do not adequately distinguish between non-price-related antitrust conduct that should be prohibited *per se* (such as output restrictions and territorial and customer allocation), and conduct that should be analyzed under a rule of reason approach (such as restrictions on technology/equipment purchase and development). SAIC's revised leniency program does not specify the types of agreements to which leniency will apply or clearly explain the requirements to qualify for leniency. The reduced level of legal certainty is likely to impair the leniency program's effectiveness in motivating companies to apply for leniency.

The Dominance Rules, by contrast, improve on the prior draft by clarifying that allegedly abusive conduct will be examined under a rule of reason standard. On the other hand, the Dominance Rules seem to broaden the definition of a dominant position, as well as the "essential facility" doctrine. The Chinese version of the doctrine is broader than that applied in either the U.S. or Europe, where a dominant company generally is not required to provide access to an "essential facility" unless such access is necessary for the competitor to provide a new product or service, not merely "to effectively operate."

Despite their limitations, the three draft substantive rules, together with the two procedural rules already in effect, will when finalized constitute a relatively complete body of implementing rules for SAIC and should enable SAIC to move forward with its enforcement activity.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Antitrust and Competition in the "Practices" section of our website at http://www.clearygottlieb.com.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

CLEARY GOTTLIEB

Office Locations

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

PARIS
12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

MOSCOW
Cleary Gottlieb Steen & Hamilton LLP
CGS&H Limited Liability Company
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE
Theodor-Heuss-Ring 9
50668 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME
Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN
Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING
Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax