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SAIC Issues Rules under the Chinese Anti-Monopoly Law

The Anti-Monopoly and Anti-Unfair Competition Enforcement Bureau ("AACEB") of the State Administration for Industry and Commerce ("SAIC"), which is responsible for enforcing the Chinese Anti-Monopoly Law (the "AML") with regards to non-price-related conduct, has published two draft substantive rules, regarding the application of the AML to abuses of dominant market positions and restrictive agreements, and two final procedural rules, on the investigation of abuses of dominant positions, restrictive agreements and abuses of administrative power that restrict competition.

The draft rules take a broad approach to certain categories of abusive conduct (particularly refusals to deal, tying and bundling, and discriminatory treatment), as well as to the types of agreement that may be considered "restrictive" under the AML. The rules outline the first leniency program to be proposed by the Chinese antitrust authorities. The final procedural rules detail SAIC's procedure in enforcing the non-price-related provisions of the AML, including the jurisdiction of provincial authorities, and set out (generally toothless) procedures for SAIC to follow in respect of administrative abuses, such as government bodies compelling companies to engage in conduct that violates the AML.

While the Anti-Monopoly Bureau of the Ministry of Commerce ("MOFCOM") has published a number of guidelines and implementing rules in draft or final form and has actively exercised its jurisdiction over mergers and acquisitions,[1] SAIC's issuance of the draft and final rules marks the first time SAIC has used its rule-making authority to flesh out relevant AML provisions. According to press reports, SAIC has received a large number of complaints under the AML but has so far not adopted any decisions, or even launched formal investigations, regarding these complaints. SAIC's issuance of the rules described in this memorandum may indicate that SAIC is now prepared to play a more active role in enforcing the AML.

[1] For example, the acquisitions of Anheuser-Busch by Inbev and Lucite by Mitsubishi Rayon were approved with conditions, and the proposed acquisition of Huiyuan by Coco-Cola was prohibited.

I. BACKGROUND

In August 2008, the AACEB of SAIC, MOFCOM, and the Price Supervision Department of the National Development and Reform Commission (the "NDRC") were designated as Anti-Monopoly Enforcement Authorities under the AML. The responsibility for enforcing the AML is allocated as follows:

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

II. DRAFT SUBSTANTIVE RULES

The two draft rules published by SAIC on April 27, 2009, are the following:

- Draft Rules on Prohibition of Abuse of Dominant Market Positions (the "Dominance Rules"); and
- Draft Rules on Prohibition of Restrictive Agreements (the "Restrictive Agreements Rules").

These draft rules are discussed below.

A. THE DOMINANCE RULES

The Dominance Rules offer guidance in respect of (1) SAIC's definition of a "dominant market position"; (2) how SAIC will determine whether a company or companies hold a dominant market position; and (3) conduct that SAIC views as abusing a dominant market position.

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 clarify the phrases "other transactional terms" and "ability to impede or affect other undertakings' ability to enter the relevant market":

- "Other transactional terms" include "factors other than price and quantity of products that may materially affect market transactions, such as product quality, payment conditions, delivery methods, and after-sale services, *etc*."

- "The ability to impede or affect other undertakings' ability to enter the relevant market" refers to "the ability to exclude from or delay entry into the relevant market by other undertakings in reasonable time or increase considerably the costs of entry into the relevant market by other undertakings such that they cannot effectively compete with the incumbent undertakings."

2. Determination of a Dominant Market Position

The Dominance Rules provide further guidance with regard to the AML's non-exhaustive list of factors used to determine whether a company holds a dominant market position:

- Market share and the "competitive situation":

    - With respect to market shares, the Dominance Rules restate the AML's rebuttable presumption of market dominance: a dominant market position is presumed when the market share of one company reaches one-half of the relevant market, the aggregate market share of two companies reaches two-thirds of the relevant market (except for companies having a market share of less than one-tenth of the relevant market), or the aggregate market share of three companies reaches three-quarters of the relevant market (except for companies having a market share of less than one-tenth of the relevant market).

    - The "competitive situation" includes such factors as the level of development of the relevant market, the number of existing competitors, the existence of potential competitors and barriers to entry, market shares of other companies, the degree of product differentiation, and market transparency. Factors relevant to barriers to entry include rules affecting market access, the role of networks and other necessary facilities, sales channels, capital requirements, technological requirements, economies of scale, and cost advantages.

- Upstream and downstream markets: The degree to which the company in question controls sales channels or raw material supplies, including its ability to affect or determine price, quantity, contract terms or other transactional terms, or to acquire raw materials on a preferential basis.

- Financial and technological strength: The relevant company's assets, financial condition, profitability, access to financing, research and development capabilities, technical equipment, and intellectual property rights.

- Dependency of other companies: Relevant factors include the volume of other companies' transactions with the allegedly dominant company, the duration of the relationship, and the difficulty with which counterparties can switch to an alternative counterparty.

The Dominance Rules set out types of evidence that can be used to rebut the presumption of dominance:

- Evidence that other companies can easily enter the relevant market.

- Evidence that there is a reasonable degree of competition in the relevant market.

- Evidence that the company in question is unable to control prices, quantities of products sold or other transactional terms, or to impede or affect other companies' access to the relevant market.

To rebut the presumption that two or three companies are jointly dominant in a relevant market, those companies must also show that there is substantial competition between them and that no individual company possesses a "prominent market position" compared to the others.

Perhaps the most noteworthy aspect of the approach to the definition of a dominant market position embodied in the AML and confirmed in the Dominance Rules is the over-reliance on market shares. While market shares provide a useful first indication of companies' relative positioning in the marketplace, they are an insufficient indicator of dominance, particularly when applied to a group of companies and the alleged exercise of "collective dominance." A proper assessment requires a detailed factual and economic analysis of the market's structure and must occur on a case-by-case basis.

3. Abuses of Dominant Market Positions

The Dominance Rules elaborate on practices prohibited by the AML as abuses of dominant market positions:

a. Refusals to deal and exclusive dealing

A dominant company may not reduce, restrict, or terminate current transactions with counterparties or refuse to engage in new transactions with counterparties without justifiable reasons. The Dominance Rules provide that refusing, reducing, restricting or

terminating transactions with counterparties under the same conditions that applied when previous transactions were entered into may be deemed to be "without justifiable reason".

The Dominance Rules also introduce the concept of an "essential facility" doctrine. A dominant company may not deny other companies the use of necessary networks or other facilities under reasonable terms, if the other company cannot otherwise commence operations.

With respect to exclusive dealing, the Dominance Rules restate the relevant AML provision (*i.e.*, a dominant company is prohibited from restricting its counterparty to trade only with it or with a company designated by it without justifiable reasons).

Because the Dominance Rules define prohibited refusals to deal and exclusive dealing so broadly, conduct by a dominant company that would likely be legal under U.S. or EU antitrust law could violate the AML. Moreover, the SAIC's proposed version of the "essential facility" doctrine is overly broad. At the very least, dominant companies should not be 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 commence operations." In addition, the Dominance Rules should make clear that a dominant company's products or services will not be considered "essential" if a competitor could practically/reasonably duplicate that product or service.

The AML and the Dominance Rules leave a dominant company the possibility to defend conduct that might otherwise be characterized as abusive by providing "justifiable reasons". However, it appears that the dominant company bears the burden of proof in this respect. The Dominance Rules offer no guidance on the nature of the reasons that SAIC will consider "justified" in different scenarios, nor on the types of evidence that will be required for a dominant company to meet its burden of proof.

b. Tying and bundling

Dominant companies, without justifiable reason, may not impose "bundled sales" or other unreasonable trade terms, such as conditioning a sale upon the counterparty's purchase of other products or promise not to purchase from other companies; bundling sales of two or more products that can be sold separately; or charging a higher price for a product sold individually than the same product sold in a bundle.

Again, the Dominance Rules offer little practical guidance on the types of tying and bundling arrangements that will be considered "unreasonable" or the reasons that SAIC will regard as "justifiable" when dominant companies seek to show that their arrangements are not abusive. The Dominance Rules also do not deal with some of the more difficult definitional issues that have arisen in cases in the United States and the EU, such as the treatment of so-called "technical tying".

c. Discriminatory terms

A dominant company is prohibited, without justifiable reasons, from discriminatory treatment of counterparties with respect to transaction terms, such as the quantity and quality of goods or services, payment conditions, delivery methods, and after-sale services, in "equivalent transactions".

The Dominance Rules define an "equivalent transaction" as a "transaction conducted with respect to the same or similar products under the same or similar transaction terms, such as transaction volumes, during the same or similar time period."

The Dominance Rules again offer no guidance on the nature of the reasons that a dominant company can advance to justify "discriminatory" conduct. The Dominance Rules' rather vague definition of "equivalent transactions" is also likely to give rise to debate as it is applied in specific cases.

B. THE RESTRICTIVE AGREEMENTS RULES

The Restrictive Agreements Rules provide guidance with respect to (1) the definition of "restrictive agreements"; (2) types of restrictive agreements that are prohibited under the AML; (3) the role of industry associations; and (4) SAIC's proposed leniency program.

1. Definition of Restrictive Agreements

The Restrictive Agreements Rules provide that "agreements" that may be found restrictive under the AML include written agreements, oral agreements and concerted practices (with explicit or tacit collusion). To determine whether practices are in fact "concerted," SAIC will consider the degree of consistency in the relevant companies' behavior, the existence (or not) of legitimate reasons for identical or similar acts other than concertation, the structure of the relevant market, and market changes.

The factors set out in the Restrictive Agreements Rules to determine what practices will be considered "concerted" are quite vague. By contrast, there is well-developed precedent in the United States and Europe regarding the analysis of available evidence (known in the United States as "plus factors") to determine whether concerted action rises to the level of an illegal agreement, and the government carries a fairly high burden of proof.

2. Prohibited Restrictive Agreements

The Restrictive Agreements Rules generally follow the AML's prohibition of horizontal and vertical restrictive agreements and provide further details on non-price-related restrictive agreements. However, the following differences are noteworthy.

The Restrictive Agreements Rules include bid rigging as a category of prohibited horizontal restrictive agreement, and conspiracies between auctioneers and bidders as a category of prohibited vertical restrictive agreement. These categories are not mentioned in the AML, but are covered by other laws, the Law on Invitation and Submission of Bids and the Anti-Unfair Competition Law.

The Restrictive Agreements Rules appear to expand the scope of explicitly prohibited vertical agreements under the AML, which explicitly condemned only two price-related vertical restrictive agreements. The Restrictive Agreements Rules prohibit not only agreements between an auctioneer and bidders, but also, without justifiable reasons, agreements between a company and counterparties that restrict the geographic markets in which counterparties may conduct business and agreements that require exclusive dealing between counterparties and the allegedly dominant company or other companies designated by it.

3. Rules for Industry Associations

The AML prohibits trade associations from "facilitating" restrictive agreements. The Restrictive Agreements Rules provide guidance as to what constitutes "facilitation" by specifying a number of activities (*e.g.*, formulating and promulgating industry rules, decisions, notices, *etc.* that exclude or restrict competition; convening members to discuss and form agreements, resolutions, minutes, memoranda, *etc*.; facilitating the communication, discussion, and coordination towards reaching restrictive agreements among companies) that industry associations are prevented from taking.

4. Leniency Program

The Restrictive Agreements Rules allow a company that engages in prohibited activities under the draft Restrictive Agreements Rules to seek an exemption or reduction in penalties if it provides SAIC with important evidence enabling SAIC to initiate an investigation or that plays a key role in proving a violation. The first company to provide such evidence will get immunity from sanction, the second will receive a 50% reduction, and the third will receive a 30% reduction. However, the immunity or reduction would not apply to companies that initiated the restrictive agreement or coerced others to enter into the restrictive agreement.

While SAIC's proposed leniency rules are a welcome innovation in Chinese antitrust law, the Restrictive Agreements Rules leave many questions unanswered. For example, they do not specify the types of agreements to which leniency will apply. Typically, leniency policies apply to both price and non-price-related cartel behavior, as cartels are secretive in nature and therefore difficult to uncover using normal investigative methods, while other restrictive agreements may have pro-competitive effects that would complicate the analysis under a leniency program. Furthermore, the requirements to qualify for leniency lack clarity, and it will be difficult for a party to be

sure that it has done everything necessary to obtain leniency. It also remains to be seen whether the immunity and reduction of penalties apply only to fines, or also to confiscated proceeds (see below). Importantly, it is unclear whether SAIC/AICs retains discretion to deny leniency to an applicant that meets all of the established criteria.

C. PENALTIES

Both the Dominance Rules and the Restrictive Agreements Rules contain sections on penalties for violation of the AML that merely repeat the sanctions that can be imposed under the AML (an order to cease illegal behavior, confiscation of illegal proceeds, and fines of not less than 1% but not more than 10% of turnover for the preceding year or not more than RMB 500,000, in the case of restrictive agreements that were not implemented and violations by industry associations (whose registration may also be canceled in serious cases)). The Restrictive Agreements Rules state that if companies conclude restrictive agreements through industry associations, both the companies involved and the industry association shall be subject to sanction.

The draft rules miss an opportunity to clarify a number of questions that have arisen with respect to the application of the penalties provisions of the AML. It remains unclear, for example, whether the relevant "turnover" upon which fines are calculated is global or national, and whether the turnover of all lines of business is relevant or only turnover generated by the relevant products.

D. SAIC'S JURISDICTION

Both the Dominance Rules and the Restrictive Agreements Rules provide that SAIC may authorize the provincial authorities responsible for industry and commerce to investigate and sanction non-price-related restrictive agreements, in particular those that take place exclusively or principally within their respective jurisdictions. How jurisdiction will be allocated in specific cases is discussed in more detail in the procedural rules discussed below.

III. FINAL PROCEDURAL RULES

The two final rules adopted by SAIC on June 5, 2009, are the following:

- Procedural Rules on Investigating and Handling Cases of Restrictive Agreements and Abuse of Market Dominance by the Administrative Authority of Industry and Commerce (the "Investigation Rules"); and

- Procedural Rules on Prohibiting of Acts of Abuse of Administrative Power to Eliminate or Restrict Competition by the Administrative Authority of Industry and Commerce (the "Administrative Power Rules").

The rules take effect as of July 1, 2009.

A. THE INVESTIGATION RULES

The Investigation Rules provide more detail on the conduct of investigations of alleged restrictive agreements or abuses of dominant market positions and the allocation of jurisdiction between SAIC and its provincial authorities.

The Investigation Rules set out the information that should be included in a written complaint to the administration of industry and commerce, including basic information regarding the complainant or informant, basic information on the allegedly offending companies, basic facts regarding the alleged anti-competitive conduct, relevant evidence and sources of evidence, and whether the same facts have been reported to other administrative authorities or been the subject of court action. If these requirements are not satisfied, complainants or informants will be asked to supplement the information provided. A written complaint can also be submitted on a no-name basis.

The Investigation Rules detail the steps that may be taken by SAIC or provincial administrations of industry and commerce ("AICs") in conducting their investigations. These steps include visiting a company's offices, requesting information from the relevant businesses and other interested parties, copying documents, and issuing questions to the party(ies) under investigation. Failing to respond within the required time limit or providing incomplete or fraudulent materials subjects a company to fines and potential criminal liability as referred to in Article 52 AML.

During the course of an investigation, a company may apply for suspension of the investigation based on a commitment to eliminate the effects of the anti-competitive conduct through concrete steps within a specified timetable. Acceptance of the commitments is solely within the discretion of SAIC and the AICs (subject to SAIC's oversight). SAIC/AICs will monitor compliance with the commitments and may reopen the investigation if necessary. It remains unclear whether the commitments mechanism will apply to cartels, and the Investigation Rules do not clarify whether SAIC/AICs are obliged to terminate an investigation within a specific time frame following fulfillment of the relevant commitments.

If a company is not satisfied with the decision of SAIC/AICs, it may apply for an administrative reconsideration or file an administrative lawsuit in the relevant court.

As discussed above, SAIC/AICs may exempt a company from penalty or impose reduced penalties if the company meets the requirements of the leniency program. The Investigation Rules state that leniency is not available for the organizer of a restrictive agreement. Also, if a company can prove that an agreement falls under one of the exemptions listed in Article 15 of the AML, SAIC/AICs may exempt the agreement from legal enforcement.

SAIC may delegate authority on a case-by-case basis to an AIC to handle activity solely taking place within the AIC's region, primarily occurring in the AIC's region, and as otherwise determined by SAIC. Both SAIC and AICs may begin an inquiry either ex-officio or based on a complaint or information from third parties. Although both SAIC and AICs can begin an "inquiry", only SAIC may launch a formal investigation or authorize an AIC to do so. An AIC that is authorized to conduct a formal investigation must report to SAIC before making any decision to suspend or end an investigation or to impose an administrative penalty. SAIC must report any "significant" cases to the Anti-Monopoly Commission of the State Council before imposing an administrative penalty.

SAIC's delegation of powers to AICs is broader than that authorized by MOFCOM in circulars issued in March 2009, which authorize provincial departments to cooperate in merger investigations and antitrust conduct distorting foreign trade in the respective regions. Under the Investigation Rules, AICs may not only investigate but also, after reporting to SAIC, render final decisions and impose sanctions for non-price-related anti-competitive conduct, which provincial authorities may not do under MOFCOM's circulars. In this respect, it is of particular importance that SAIC takes an active role to ensure the consistent enforcement among all its agencies at the provincial level.

B. THE ADMINISTRATIVE POWER RULES

Chapter Five (Articles 32-37) of the AML prohibits the abuse of administrative power to eliminate or restrict competition, such as an instruction by a government body requiring a company to engage in anticompetitive conduct. Under Article 51, however, when such an abuse occurs, it is up to the superior authority of the authority accused of the violation to correct the situation; anti-monopoly authorities may only propose the action to be taken.

Given SAIC's limited authority in this area, the Administrative Power Rules not surprisingly are short, at only 11 articles, and do not provide SAIC/AICs with much power. As per the AML, SAIC/AICs may only make recommendations to the appropriate superior administrative authorities for action. If central government agencies or provincial governments abuse their administrative power to eliminate or restrict competition, SAIC may submit its recommendations to the State Council. It is expected that a separate set of substantive rules will be issued concerning the handing of abuse of administrative power cases.

Importantly, the Administrative Power Rules note that it is not an acceptable defense for a business to argue that it was compelled, instructed, or authorized to engage in anti-competitive conduct by an administrative authority or organization. No distinction is made between anti-competitive actions that were "compelled", on the one hand, from anti-competitive conduct that was "instructed" or "authorized," on the other hand. It remains to be seen how SAIC/AICs will balance the Administrative Power

Rules and Chapter 5 of the AML (prohibiting the abuse of administrative power to eliminate or restrict competition).

IV. CONCLUSION

The draft rules published by SAIC regarding abuse of dominance and restrictive agreements and the final procedural rules on investigations and abuses of administrative power may signal SAIC's readiness to play a larger role in the enforcement of the AML. Although welcome, these rules leave many questions unanswered. In addition to the specific comments above, the following general observations are relevant.

The draft rules do not adequately distinguish between non-price-related antitrust conduct that should be prohibited *per se* (such as output restrictions, territorial and customer allocation, and bid-rigging), and conduct that should be analyzed under a *rule of reason* approach that considers the effects and justifications for the alleged conduct. Similarly, the draft rules do not sufficiently stress the need to show actual or likely anti-competitive effects -- harm to consumers by way of a reduction in the number of competitors, amount of innovation, foreclosure of reasonably efficient competitors, *etc.* -- of abusive practices or restrictive agreements.

SAIC's form-based approach may raise issues particularly in an area that has been controversial in the United States and the EU in recent years; the interface between the abuse of dominance rules and intellectual property rights. It would have been useful, for example, if the Dominance Rules had addressed the circumstances in which dominant companies may be required to grant patent licenses or provide interoperability information to competitors.

Although the draft Dominance Rules and Restrictive Agreement Rules provide that a dominant company may defend conduct that would otherwise violate the AML based on "justifiable reasons" for its conduct, the rules apparently place the burden of proof on the dominant company while offering no guidance on what justifications SAIC will consider in different scenarios and the nature of the evidence that dominant companies will be required to provide.

The draft and final rules apply only to anti-competitive conduct under the jurisdiction of SAIC/AICs. The NDRC has yet to issue similar guidance regarding price-related conduct. Moreover, the rules do not provide any additional detail regarding the split in jurisdiction between SAIC/AICs on one hand and NDRC (and its local agencies) on the other hand. It is reported that during the drafting process, SAIC consulted and reached consensus with the NDRC regarding topics such as the contents of complaints/reports, the commitment mechanism, the leniency program, and the obligation of the company/individuals under investigation to provide relevant information, to ensure transparency, clarity, and consistency. Coordination and

consistency between SAIC and the NDRC will be particularly important as the agencies develop and implement their respective leniency programs, since cartel violations often involve both price- and non-price-related conduct.

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