



# China finally enacts Anti-monopoly Law

The Standing Committee of the National People's Congress (NPC) formally adopted the Anti-monopoly Law (AML) on 30 August 2007. The AML will come into force on 1 August 2008. This briefing summarises some of its key provisions, highlights some of the major improvements on the June 2007 draft, and discusses the major implications for foreign companies doing business in China.

On 30 August 2007, after more than a decade of legislative efforts, the Standing Committee of the National People's Congress (NPC), China's top legislature, completed its third official reading of the draft Anti-monopoly Law (AML) and formally adopted it as the country's first comprehensive competition law. The AML will become effective on 1 August 2008.

This briefing follows our August briefing on the second reading of the draft AML by the Standing Committee of NPC in June 2007 (the June 2007 draft). It summarises certain key provisions of the AML, highlights some of the major improvements to the June 2007 draft, and discusses the major implications for foreign companies doing business in China.

## Key provisions of the AML

Like other comprehensive competition law regimes, the AML addresses three main areas, namely: the prohibition of anti-competitive monopoly agreements; the prohibition of the abuse of a dominant position; and merger control. Most provisions derive from European or German antecedents and are generally in line with international norms. However, some of the provisions have arguably distinctive 'Chinese characteristics' and it will be interesting to see how these manifest themselves in the implementation and enforcement of the law. The AML also covers a fourth area, the prohibition of administrative monopolies, which addresses the anti-competitive effects of misuse of government power.

## Extraterritorial application

In addition to 'monopolistic conduct within China', article 2 also provides that the law applies to 'monopolistic conduct' outside China that 'eliminates or has a restrictive effect' on competition in the Chinese domestic market. Notably, a strict textual reading of article 2 does not require the anti-competitive effect in China of extraterritorial conduct to be substantial or foreseeable in order to give rise to an issue under article 2. Therefore, a concern arises about the potential application of the AML by the Chinese competition authorities to extraterritorial conduct with indirect, insubstantial or unforeseeable effects in China.

## Monopoly agreements

Chapter 2 (Monopoly Agreements) is roughly analogous to the regimes under article 81 of the EC Treaty and Section 1 of the Sherman Act. It distinguishes between horizontal and vertical agreements. Horizontal monopoly agreements 'among undertakings with competing relationships' are prohibited. Article 13 of the AML provides a non-exhaustive list of prohibited horizontal monopoly agreements, including: agreements that 'fix or change prices of products', 'limit the production or sales volume of products', 'allocate the sales markets or the raw material sourcing markets', 'restrict the purchase of new technology or new equipment or restrict the development of new technology or new products' or 'jointly boycott transactions'.

Article 14 prohibits vertical agreements that fix ‘the resale price’ or the ‘minimum resale price’ and other ‘monopoly agreement as otherwise determined by the enforcement authority’. It is noteworthy that under earlier drafts of the AML resale price maintenance was prohibited per se with no distinction between minimum and maximum resale prices. Under the current article 14, agreements to fix the maximum resale price are no longer explicitly prohibited, although they may nevertheless infringe the AML if they can be characterised as an anti-competitive agreement ‘as otherwise determined by the enforcement authority’ under the AML. This ‘catch-all’ clause can also be invoked by the enforcement authority regarding horizontal agreements that do not otherwise fall within the list of prohibited horizontal monopoly agreements at article 13.

Certain exemptions may be available under article 15 for agreements that improve technology or research and development, enhance product quality, reduce cost, improve efficiency, unify products specifications or standards, enhance the competitiveness of small and medium-sized business, or are otherwise for the benefit of public interest, such as energy savings, environmental protection, disaster relief, etc. Additionally, agreements that ‘safeguard the legitimate interest in foreign trade and economic co-operation’ (the so-called ‘export cartels’) and ‘crisis’ cartels that ‘mitigate serious decrease in sales volumes or distinctive production oversupply during economic crisis’ may also be exempted. However, except for the export cartels ground, the availability of exemption on the basis of the other article 15 grounds requires additional proof that such agreements will not ‘substantially restrict competition in the relevant market’ and that consumers will be able to ‘share in the benefits of the agreements’.

### **Abuse of dominant market position**

Chapter 3 (Abuse of Dominant Market Position) generally derives from the EU competition law formulations for the assessment of single firm conduct and collective dominance. Article 6 prohibits ‘undertakings with a dominant market position’ from ‘abusing their dominant market position to eliminate or restrict competition’. It is worth noting that this article 6 was in chapter 3 in earlier drafts and has been elevated to chapter 1 (General Principles) to give it more prominence.

Article 17 defines a ‘dominant market position’ as ‘the market position held by an undertaking that is capable of controlling the price or quantity of products or other trading terms in the relevant market or restricting or affecting other undertakings’ entry into the relevant market’. Article 18 contains a non-exhaustive list of factors that can be used to establish the ‘dominant market position’ of an undertaking, including: the market share of the undertaking and the competitive conditions in the relevant market; the ability of the undertaking to control the market; the undertaking’s financial and technical capabilities; the extent of dependence on the undertaking by other undertakings; and barriers to entry. A ‘dominant market position’ can be presumed based on market shares. Under article 19, any undertaking with a market share of 50 per cent is presumed dominant. Collective dominance is presumed when two undertakings have a combined market share of two thirds, or three undertakings have a combined market share of three quarters. Regarding the determination of collective dominance, there is a safe harbour for undertakings with less than 10 per cent market share, ie undertakings with less than a 10 per cent market share would not be presumed dominant.

Similar to article 82 of the EC Treaty, article 17 of the AML contains a non-exhaustive list of types of abusive conduct, which include predatory pricing, excessive pricing, refusals to deal, exclusive dealing, tying and price discrimination. Most of these abuses are limited to conduct engaged in ‘without any reasonable justification’, which seems to suggest that a ‘rule of reason’ analysis should apply to the assessment of alleged abusive conduct by dominant firms. However, it remains to be seen how the relevant Chinese competition authority and the Chinese courts will apply this standard in practice.

### **Merger control**

Chapter 4 (Concentration of Undertakings) contains the merger control provisions. Under article 21, a concentration of undertakings that ‘meets the relevant thresholds for notification as stipulated by the State Council’ will be required to undergo pre-notification filing with the relevant competition authority designated by the State Council and receive clearance before it

can be consummated. The competition authority may block, or approve subject to restrictive conditions, concentrations that 'have or may have the effect of eliminating or restricting competition'.

Article 20 defines 'concentration of undertakings' as involving any of the following: mergers; acquisition of control of other undertakings through means of acquisition of shares or assets; or acquisition of control or the capability of imposing decisive influence over other undertakings by contract or other means. As this definition failed to clarify the key terms 'control' or 'decisive influence', whether a given transaction (in a less obvious case of acquisition of 49 per cent shares, for example) would constitute a 'concentration' under the AML remains uncertain, and will likely be clarified in the implementation regulations of the AML (the Implementing Regulations). The AML also expressly leaves the relevant notification thresholds to be specified in the Implementing Regulations. It is expected that the Implementing Regulations will be published before the AML becomes effective on 1 August 2008.

Significantly, the merger control review provisions of chapter 4 will supersede the existing Chinese antitrust merger review regime, which currently only apply to foreign companies and do not provide any specific penalties for non-compliance.

## Major improvements to the June 2007 draft

Compared with the earlier June 2007 draft, few substantive changes were made in the final version of the AML. Nevertheless, it is worth mentioning a few major improvements.

- A major concern with the previous June 2007 draft was whether the presumption of dominance was rebuttable. The final version of the AML has added a new provision that allows an undertaking with a presumed dominant status to provide contrary evidence to rebut such presumptions.
- Another significant change in the final version of the AML is that it has significantly increased the fines for cartels/monopoly agreements and abuse of dominance. This was achieved by reinstating in the final version of the AML the minimum fine of 1 per cent of the turnover of the violator in the preceding

year, which had been deleted in the June 2007 draft, while the maximum fine remains at 10 per cent of the turnover in the preceding year .

- Industrial and trade associations have historically played a role in facilitating the formation of cartels by their members. Propelled by the recent high profile investigation of a price cartel involving the Chinese Instant Noodle Association by the National Development Reform Commission, the final version of the AML inserted a new provision. Industrial and trade associations can now be fined up to RMB 500,000 and deprived of their business for serious offences, eg organising or facilitating their members' engagement in monopolistic conduct.

## Implications for foreign companies doing business in China

Foreign companies doing business in China need to actively consider the immediate impact of the AML on their business in China for the following reasons.

Most foreign multinational companies have been operating within the confines of the competition law regimes in their home countries, and major jurisdictions such as the US and EU, for decades. As a result, they are more attuned to the importance of compliance with competition law regimes in all of the markets in which they operate. As China is viewed as one of the most important emerging markets, no foreign multinational company can afford to risk the potential adverse consequences to their business arising from a failure to comply with the AML.

Although the AML arguably applies equally to the conduct of foreign and domestic Chinese companies, it remains to be seen how potentially competing priorities will be implemented under the AML. For example, article 7 provides that the State shall protect the legitimate operating activities of the industries dominated by 'state owned economy' and which are vital to the Chinese national economy and/or national security. Concerns have been expressed that this article is intended to give special treatment in the enforcement of the AML to large Chinese State-owned companies that operate effectively as monopolists in industries such as

telecommunications, power and petroleum, and gas. In contrast, article 31 specifically provides that acquisitions of domestic enterprises by foreign investors that may have implications for national security shall be subject to not only competition review, but also national security review.

There is growing concern over the perceived abuse of dominance by foreign companies in China. This was raised during the discussion of the draft AML where legislators called for greater regulation of abuse of dominance by foreign companies. Accordingly, foreign companies with significant market share in China will need to carefully consider conduct that may be characterised as abusive, such as exclusive dealing or refusal to deal. When a foreign company does engage in such conduct for legitimate business reasons, these justifications should be well-documented in advance to minimise antitrust risk.

Once the AML takes effect, merger and acquisition (M&A) transactions in China involving foreign parties will be subject to merger review and can be blocked on antitrust grounds or approved subject to restrictive conditions. While this is not necessarily going to slow down the pace of foreign M&As in China, it means that (as in other more mature jurisdictions) it will become critical to seek counsel's view on the competition aspects of an M&A transaction at the earliest opportunity in the deal negotiation process. It can also impact on and influence structuring decisions for the deal.

Foreign companies should also review their existing commercial agreements that have a Chinese dimension to minimise any antitrust exposure. Such enquiries could involve, for example, considering whether any agreements with their competitors could give rise to any horizontal issues, and whether any of their distribution agreements contain provisions on fixing minimum resale price, or partitioning the market by territory or customer groups, etc.

## Conclusion

The adoption of the AML is an important milestone for China in its journey as a market in transition. Like many other Chinese laws, the AML establishes the general legal framework as well as the policy and principles behind the law. Implementation Regulations are expected to be released soon. These typically will provide more granular detail and guidance on the implementation and enforcement of the law by the relevant competition authority and should prove invaluable for foreign companies in navigating their business pursuits in this new era in China.

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