



Overview of Chinese competition law



Introduction

Although merger control has been actively enforced since China's Anti-monopoly Law (AML) came into force, including quite controversially in a number of cases involving non-Chinese companies, enforcement of the so-called behavioural rules governing anti-competitive agreements and abuse of dominant market positions has been slower to start. That is expected to change soon and will lead to new risks for companies operating in China. A significant number of private damages actions have, however, already been brought before the courts, perhaps indicating that private enforcement may become a significant feature of the enforcement landscape in China.

This guide summarises the most important features of the AML, including the scope of the law and early enforcement priorities of China's multiple competition law agencies.

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Overview of the Chinese Anti-monopoly Law and enforcement agencies

Scope of the law

The AML was enacted on 30 August 2007 and came into effect on 1 August 2008. It is modelled on EU competition law and includes provisions governing anti-competitive or so-called 'monopoly' agreements (eg cartels), abuse of dominance and merger control.

The AML applies to 'monopolistic conduct within China' but also to 'monopolistic conduct' outside China that 'eliminates or has a restrictive effect' on competition in the Chinese domestic market. For the purposes of the AML, 'China' covers mainland China only, and notably therefore excludes Hong Kong (which has recently published its own comprehensive Competition Bill).

The AML contains broad principles that will guide antitrust enforcement in China. Many of the details of how the AML will be enforced in practice are left to be specified in the implementing regulations and guidance, much of which is still in draft form.

Nearly two years after the AML took effect, many uncertainties still exist and a number of questions remain open, some of which arise out of the unique features of the Chinese political and economic environment (as most amply demonstrated by the broadly interpreted 'national security' and industrial policy considerations that apply in the merger control context in particular).

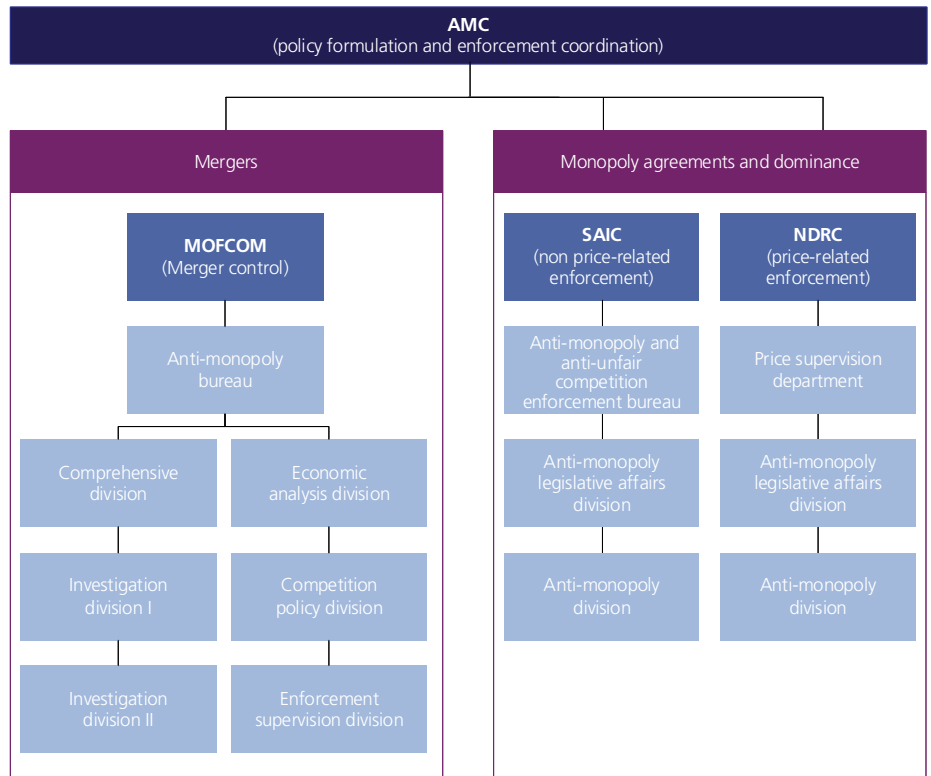
The enforcement agencies

From an organisational point of view, a complex institutional structure exists in two levels of administration and enforcement:

- on the upper level, the Anti-monopoly Commission (AMC), which reports directly to the State Council, is responsible for policy formulation and co-ordination; and
- on the lower level, no less than three anti-monopoly enforcement agencies (AMEAs) have been designated to be responsible for day-to-day enforcement of the AML:
 - the Anti-monopoly Bureau of the Ministry of Commerce (MOFCOM) has exclusive responsibility for merger control review. It is widely considered the most experienced and well-resourced agency dealing with competition matters;
 - the National Development and Reform Commission (NDRC), being the country's price regulator, is responsible for the enforcement of those aspects of the AML relating to monopoly agreements and abuse of dominance that are price-related; and

- the State Administration for Industry and Commerce (SAIC) has responsibility for the enforcement of those aspects of the AML relating to monopoly agreements and abuse of dominance that are not price-related.

Division of powers among the three enforcement agencies



Scepticism remains over the likelihood of consistent enforcement of the AML among the three AMEAs, particularly the NDRC and SAIC, which share responsibility for investigating and sanctioning non merger-related competition law infringements.

Merger control

Concentration of undertakings

Under the AML, a transaction will require pre-merger notification if it amounts to a ‘concentration of undertakings’, which is defined as:

- a merger of undertakings;
- an undertaking acquiring control over one or more undertakings by acquiring equity interests or assets; or
- an undertaking acquiring control or being able to exert a decisive influence over one or more other undertakings by contract or any other means. This may include the acquisition of certain minority interests.

Notification thresholds

If a transaction qualifies as a concentration under the AML, it is subject to a pre-merger mandatory filing if it meets one of the two turnover thresholds:

- threshold one: total worldwide turnover of all undertakings exceeded RMB10bn (approximately €1.1bn) and the turnover in China of each of at least two undertakings exceeded RMB400m (approximately €43m) in the previous financial year; or
- threshold two: total turnover in China of all undertakings exceeded RMB2bn (approximately €215m) and the turnover in China of each of at least two undertakings exceeded RMB400m (approximately €43m) in the previous financial year.

Even if neither of these thresholds is met, MOFCOM still has the discretion to review a transaction if it considers that the transaction may result in the elimination or restriction of competition in China. However, to date, we are not aware that MOFCOM has used this discretionary power.

Suspension obligation

All transactions that are caught by the notification requirement are subject to a standstill obligation until formal clearance has been obtained or the relevant waiting period has expired (see below under 'Notification process').

Foreign-to-foreign transactions

Foreign-to-foreign transactions (ie transactions involving non-Chinese companies) will be subject to the merger notification requirement in China if the above-mentioned notification thresholds are met. On this particular point, it should be noted that all the transactions in which MOFCOM has imposed remedies to date were foreign-to-foreign transactions.

Notification process

Parties are required to conduct pre-notification consultations with MOFCOM to discuss jurisdictional and legal issues, including what further information is required before acceptance and whether supplying less information or documentation may be possible. MOFCOM's record so far indicates that significant information will often need to be provided before it is willing to start the review clock. This can result in a lengthy pre-notification process.

The initial waiting period is 30 days (phase one), which can be extended by another 90-150 days (phase two).

Importance of non-competition issues

In reviewing merger cases, MOFCOM will not just evaluate 'pure' competition issues. In fact the AML expressly contemplates issues such as industrial policy and national economic security playing an important part in the review process.

‘Industrial policy’ is interpreted broadly by MOFCOM and other government ministries and includes, for example, safeguarding:

- well-known Chinese brands;
- intellectual property located or developed in China;
- research and development activities located or developed in China;
- Chinese cultural heritage; and
- Chinese interests more generally.

In addition, under the mergers and acquisitions foreign investment rules (M&A rules), transaction parties are required to report to the Foreign Direct Investment Division (FDI) of MOFCOM and seek approval for deals in which foreign investors will acquire control of domestic entities in key economic sectors or affecting economic security or well-known Chinese brands. Industrial policy considerations can also play a role in this approval process.

These non-competition factors can, and often do, lead to longer investigations than would be anticipated in the EU or US, for example, with many cases going into phase two. This must be built into realistic transaction timetables. They can also contribute to decisions to block proposed investments into China.

Monopoly agreements

The prohibition of monopoly agreements

The AML affects monopoly agreements, which are defined as ‘any agreements, decisions or other concerted actions that eliminate or restrict competition’. As in the EU, the definition of an ‘agreement’ is very broad and encompasses not only written but also oral agreements and understandings and even implicit arrangements.

The law on monopoly agreements applies to horizontal agreements (eg cartels) and some types of vertical commercial arrangements, such as distribution and supply agreements.

Cartel enforcement

To date, the SAIC’s and the NDRC’s enforcement activities have been limited. Both agencies have been primarily focused on building capacity and preparing for enforcement activity. The SAIC and NDRC substantive guidance is still in draft form.

Notwithstanding this, numerous complaints have been submitted to both the NDRC and the SAIC, which have reportedly started investigations.

The two agencies' enforcement priority is detecting and investigating the most serious 'hard-core' infringements of the AML:

- price fixing;
- output restrictions;
- market sharing;
- customer allocation;
- boycotts; and
- bid rigging.

The nature of information exchanged during trade association meetings is also expected to be under close scrutiny.

Sanctions

Possible sanctions include fines ranging from 1 per cent to a maximum of 10 per cent of the company's annual turnover, depending on the nature, seriousness and duration of the illegal conduct. However, it is unclear whether the turnover that should be taken into consideration should be the global, the Chinese or that related to the relevant product market.

If the agreement has not been implemented, the fine cannot exceed RMB500,000.

The enforcement agencies can also impose cease-and-desist orders and confiscate illegal gains.

Reputational damage is often a further factor to be considered.

Investigation powers

The enforcement agencies have wide-ranging powers, including:

- compelling production of documents;
- inspecting premises ('dawn raids');
- conducting interviews;
- inspecting and copying relevant documents in any form (hard copy, emails etc); and
- examining bank accounts.

The agencies have the power to impose fines and request possible criminal liabilities for failure to comply, intentional obstruction or destruction of materials.

Leniency applications

China operates a leniency regime under the AML.

According to draft guidance, if a company is the first to report voluntarily relevant information regarding the monopoly agreement concluded, with material evidence, it may be exempted from fines. This does not prevent

other companies from voluntarily reporting other relevant information about the same infringement. However, in this case these companies will likely be eligible only for a fine reduction.

In applying the exemption or the reduction of penalties, the authorities will take into account the time order of the reports but also the importance of the evidence provided and the degree of co-operation given by the company during the investigation.

The current NDRC draft leniency guidance provides for a 50 per cent fine reduction for the company that is second to report and 30 per cent for the company that is third to report; the current SAIC draft leniency guidance provides that the SAIC shall decide the quantum of fine reductions in its absolute discretion. This has led to calls for a consistent approach to be adopted in the two agencies' final guidance, which is due to be published this year.

Other monopoly agreements

The AML also prohibits vertical agreements (eg distribution or supply agreements) that determine the reseller's fixed or minimum resale price (ie 'hard-core' restrictions). In addition, a 'catch-all' clause can be invoked by the authorities to prohibit other types of agreements that they deem to be monopoly agreements with potential anti-competitive effects. It seems that the SAIC may adopt a fairly 'light-touch' approach to enforcement in relation to vertical agreements, including exclusivity arrangements and the imposition of territorial restrictions, especially where the firms are not 'dominant' firms in their markets.

In addition to the possible sanctions described above, the provisions of an agreement that contravene the AML are void and unenforceable.

Exemptions

Certain exemptions are available for agreements that:

- improve technology or research and development;
- enhance product quality;
- reduce cost;
- improve efficiency;
- unify product specifications or standards;
- enhance the competitiveness of small and medium-sized business; or
- otherwise benefit the public interest, such as energy savings, environment 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 a serious decrease in sales volumes during economic crises may also be exempted. However, except for export cartels, the availability of exemption requires additional proof that such agreements will

not substantially restrict competition and that consumers will be able to share in the benefits of the agreements.

Abuse of dominance

Generally, the Chinese rules on abuse of a dominant market position derive from EU competition law. The AML provides that ‘any business with a dominant position may not abuse that dominant position to eliminate or restrict competition’. A dominant market position is one 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.

A dominant market position in China can be presumed based on market shares. However, this presumption is rebuttable. Any company with a market share of at least 50 per cent is presumed dominant, or when two companies have a combined market share of at least two-thirds of a market, or when three companies have a market share of at least three-quarters of a market. Undertakings with less than a 10 per cent market share would not be presumed dominant.

The AML contains a non-exhaustive list of types of abusive conduct, which dominant undertakings are prohibited from using and which include:

- predatory pricing;
- refusal to deal;
- exclusive dealing;
- tying; and
- price discrimination.

Most of these abuses are limited to conduct engaged in by the company ‘without any reasonable justification’ or ‘unfairly’, which seems to suggest that a ‘rule of reason’ analysis should apply to the assessment of alleged abusive conduct. As there has been no public enforcement yet, it remains to be seen how the relevant authorities will apply this standard in practice.

The sanctions would be the same as for monopoly agreements.

Private actions

Under the AML, aggrieved parties can bring both stand-alone and follow-on actions for damages.

Whereas the number of public enforcement decisions remains very low, surprisingly there have been a number of stand-alone actions brought before the intellectual property courts, which have jurisdiction to hear private antitrust actions in China.

All the reported claims to date have been made on the ground of abuse of dominant market positions and of the few that have been concluded, the majority were rejected for lack of evidence of dominance. One case has settled out of court.

Draft judicial interpretations on private action litigation are under consideration by the Supreme People's Court. The interpretation is expected to clarify a few areas, such as:

- whether class actions should be opt-in (as in certain European jurisdictions, such as the UK) or opt-out (as in the US);
- whether damages should be limited to the size of losses suffered according to usual principles of Chinese law or whether provision should be made for double damages in competition-related litigation; and
- evidence rules (whether the judge should be allowed to investigate and collect relevant evidence if the parties are unable to do so).

We are still in the very early days of private enforcement in China, but the numerous actions indicate an appetite among market players to use the AML in litigation.

The future?

It is without doubt that China's enforcement agencies have ambitions to be at the forefront of competition law enforcement on the global stage. The speed with which MOFCOM has built up its expertise in the area of merger control is testament to this, also demonstrated by its willingness to intervene in transactions, sometimes controversially. It remains to be seen how the NDRC and SAIC organise themselves in practice consistent with their unusual price and non-price jurisdictional lines of authority, but it would not be surprising to see the start of vigorous enforcement before too long, with those agencies setting their sights not only on MOFCOM's achievements but also on the successful involvement of the courts in private damages actions in these early days of competition law enforcement in China. If they have not already done so, companies operating in China would be wise to prepare for this new era.

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