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China Anti-Monopoly Law

I. Introduction

Recently, the reinforcement of anti-monopoly measures by the PRC government has triggered an antitrust storm amongst domestic and foreign companies within the country. Following the announcement of an anti-monopoly investigation into Qualcomm Inc., Microsoft received a warning from the State Administration of Industry and Commerce ("SAIC") to refrain from obstructing the ongoing anti-monopoly investigation. Thereafter, Chrysler Corporation, Audi AG and Mercedes-Benz were also faced with anti-monopoly investigations.

Li Keqiang, China's Prime Minister, expressed that the anti-monopoly efforts by the SAIC will not aim at foreign enterprises only, and no selective enforcement will be applied to them. Whether such statement reflects the facts remains to be seen.

This issue of the China Legal Report purports to provide an overview of the framework of the anti-monopoly regime in PRC, to introduce the main types of monopolistic conducts under Chinese law with some detailed discussion regarding anti-monopoly measures in merger and acquisition, and show possible remedies for companies faced with anti-monopoly investigations or infringements through monopolistic acts.

II. Legislative Framework and Supervision Authorities

The *Anti-monopoly Law of the People's Republic of China* ("the Anti-monopoly Law") provides the primary legal basis for the discussion of the anti-monopoly regime in China. The *Anti-monopoly Law* became effective on 1 August 2008, subjecting both monopolistic practices within the territory of China and extraterritorial monopolistic practices with competition-restricting and competition-eliminating effect in China under its regulatory regime.

Pursuant to Art. 3 of the *Anti-Monopoly Law*, the monopolistic practice with which it intends to cope includes the following three main types: (a) monopoly agreements reached between business operators; (b) abuse of dominant market position by business operators; and (c) concentrations of business operators that lead, or may lead to elimination or restriction of competition.

As the *Anti-monopoly Law* covers a wide range of business practices in the market, multiple government authorities are involved in the implementation of the *Anti-monopoly Law* in China. The currently responsible authorities include the SAIC, the National Development and Reform Commission ("the NDRC") and the Ministry of Commerce ("MOFCOM"). Each authority is assigned with specific executive powers as follows in the fight against monopolistic practices:

(1) The SAIC: to review, determine and execute punitive measures with regard to monopoly agreements and abusive practice of dominant market position (except for those related to price fixing);

(2) The NDRC: to review, determine and execute punitive measures with regard to price fixing either in the form of monopoly agreements or abusive practice of a dominant market position;

(3) MOFCOM: to review and approve the concentration procedure of business operators and execute punitive measures if necessary.

Meanwhile, it is also worth noting that even though it is not listed as one of the monopolistic practices in Art. 3 of the *Anti-monopoly Law*, any government authority or its authorized agency is prohibited from abusing its administrative power to restrict or eliminate competition. The NDRC and the SAIC and their counterparts on the provincial or municipal level will have the supervisory power over any prohibited practice of any government authority or its authorized agency.

III. Monopolistic Conducts in PRC

As explained in the last section, there are three common monopolistic practices with which foreign-invested enterprises would most probably relate. In this section, only the first two main monopolistic practices, monopoly agreements and abuse of a dominant market position, are introduced; the concentration of business operators will be discussed in detail in the following chapter.

A. Monopoly agreement

According to the *Anti-monopoly Law,* monopoly agreements refer to agreements, decisions and other concerted behaviour that will eliminate or restrict competition. The *Provisions on the Prohibition of Monopolistic Agreements* promulgated by the SAIC ("the Provisions") further specify the criteria upon which the determination of concerted behaviour shall be made: (a) whether there is uniformity in the market behaviour of the business operators; (b) whether there has been communication of intention or exchange of information among the business operators; and (c) whether business operators can provide reasonable explanations for their concerted behaviour. Apart from the three main criteria, other factors such as structure, competition, variation and industry in the relevant market shall be considered.

According to the *Anti-monopoly Law* and the *Provisions*, agreements entered into for the following purposes are likely to be identified as monopoly agreements that are strictly prohibited:

(1) For agreements entered into among competing operators (also referred to as horizontal monopoly):

1. To change or fix the price of certain products; or

2. To restrict the manufacture or sales volume of certain products; or

3. To allocate the shares in the sales market or in the raw material procurement market; or

4. To restrict the purchase of new technology and new equipment or to restrict the development of new products and new technology; or

5. To boycott certain transactions.

(2) For agreements entered into between a business operator and its transaction party further up or down on the supply chain (also referred to as vertical monopoly):

1. To fix the price of product sold to a third party; or

2. To limit the minimum price of product sold to a third party.

On a related note, industry associations are also prohibited from soliciting business operators to enter into monopoly agreements prohibited by the Anti-monopoly Law and the Provisions.

B. Abuse of dominant market position

For a business operator with dominant market position, it is comparatively easy and thus more likely that certain of its actions will have a significant impact on the normal course of competition on the market. This is why, if a business operator is determined to have dominant market position, the Anti-monopoly Law restricts certain behaviours by such business operator.

(1) The determination of dominant market position

Any business operator that fits one of the following conditions shall be presumed to have a dominant market position:

1. The market share of one business operator accounts for 1/2 or more in the relevant market; or

2. The joint market share of two business operators accounts for 2/3 or more in the relevant market; or

3. The joint market share of three business operators accounts for 3/4 or more in the relevant market.

Under condition 2 and 3, if one of the operator actually accounts for less than 1/10 of the relevant market share, such business operator shall not be considered as having a dominant market position.

What also needs to be noted is that although a business operator could be presumed to have a dominant market position, such business operator could object to the presumption by providing opposing evidence to the competent authority in order to avoid unnecessary restrictions posed by the Anti-monopoly Law.

(2) Some of the typical conduct regarded as abuse of a dominant market position:

1. To purchase products at an unjustly low price or to sell products at an unjustly high price; or
2. To sell products at prices lower than cost without any just cause; or
3. To refuse to deal with a certain transacting party without any just cause.

C. Legal consequences of monopolistic conducts

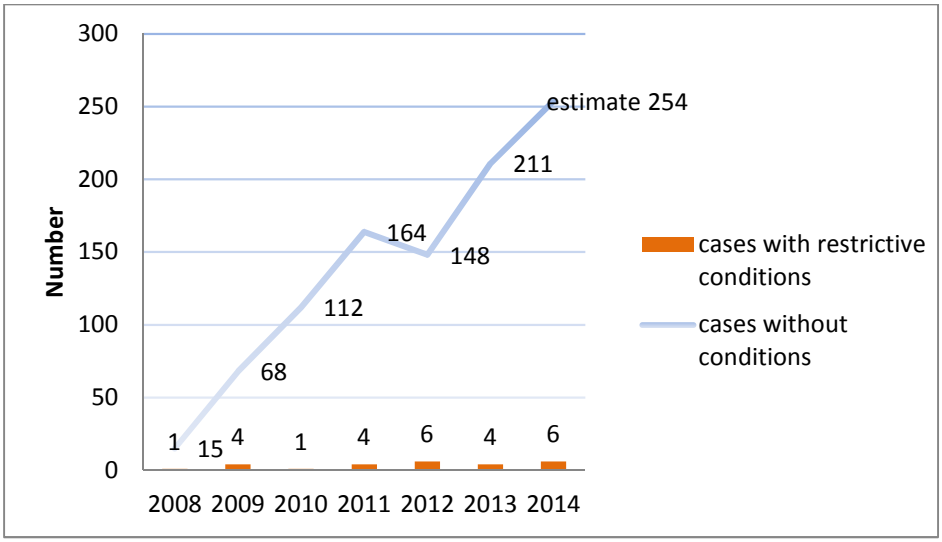
Overall, where a business operator is in violation of the provisions of the Anti-monopoly law, the competent authorities shall instruct it to discontinue the violation, confiscate its unlawful gains, and in addition, impose a fine of no less than one percent but not more than 10 percent of its sales revenue achieved in the previous year. For the monopoly agreement violations, if such monopoly agreement has not been implemented, it may be fined not more than RMB 500,000.

It is interesting to know that under the Anti-monopoly Law, there is a special regime called "System of Forgiveness", where if the business operator, on its own initiative, reports to the authority and provides material evidence on its monopoly agreement violations, the said authority may, at its discretion, mitigate or exempt such business operator from punishment.

IV. Anti-monopoly in M&A

According to Art. 21 of the *Anti-monopoly Law*, once the concentration of business operators reaches certain thresholds prescribed by the State Council (which will be discussed in the section below), a declaration on concentration has to be filed with the competent authority; before such declaration is approved, the concentration shall not proceed.

Since the promulgation of the *Anti-monopoly Law*, MOFCOM, as competent authority in charge of approving concentrations of business operators, has reviewed 855 cases. Among which, 827 cases were given approval without additional conditions, 26 cases were given approval with restrictive conditions and 2 cases were prohibited from carrying out the concentration. The statistical table below shows respective ratio of cases approved with and without additional conditions (source: MOFCOM).



Statistics of total cases and cases with restrictive conditions

A. Declaration of concentration

According to Article 2 of the *Guiding Opinions on Reporting the Concentration of Operators* issued by the Ministry of Commerce (revised in 2014), the declaration obligation with MOFCOM is triggered once the concentration reaches any of the following thresholds: (a) the worldwide business turnover of all the business operators involved in the concentration exceeds RMB 10 billion in the last accounting year, and the business turnover in China of at least two business operators among them exceeds RMB 400 million separately in the last accounting year; or (b) the business turnover in China of all the business operators involved in the concentration exceeds RMB 2 billion in the last accounting year, and the business turnover in China of at least two business operators among them exceeds RMB 400 million separately in the last accounting year. For the calculation of the turnover figures for the thresholds set out above, not only the turnover of the individual business operators who participate in a transaction of concentration must be included, but also the turnover of all business operators directly or indirectly controlling or in the control of the business operators participating in the transaction (i.e. the entire "group").

There are two exceptions to this general rule on declaration obligation. According to Art. 22 of the *Anti-monopoly Law*, a concentration under any of the following circumstances may be exempted from declaration with MOFCOM: (a) amongst all business operators involved in the concentration, one business operator possesses 50% or more of the voting shares or asset of every other business operator; or (b) a business operator not involved in the concentration possesses 50% or more of the voting shares or assets of every business operator that is involved in the concentration.

B. Anti-monopoly Review

In accordance with Art. 25 of the *Anti-monopoly Law*, MOFCOM shall, within 30 days upon receipt of the relevant documents and materials, conduct a preliminary examination of the declared

concentration and make a decision on whether to conduct further examination, and notify the business operators of that decision in written form. Thereafter, where MOFCOM decides to conduct further examination, it shall, within 90 days from the date of decision, complete the examination (under some specific circumstances, MOFCOM can extend the time for no more than 60 days). In practice, it usually takes six to twelve months from the notification of concentration to the completion of the review, but in some case, it can be longer.

C. Which factors will MOFCOM take into consideration?

The following factors are normally taken into consideration by the MOFCOM when approving a concentration declaration: (a) the control power over the market and market share of the business operator; (b) concentration ratio of the relevant market； (c) impact on market entry and technological progress; (d) influence on consumers and other business operators; (e) impact on domestic economy; etc.

The general definition of the factors to be considered gives MOFCOM considerable discretion over its decision on whether to approve the declared concentration. For more in-depth analysis on the decision making process of MOFCOM, one can refer to the past decisions reached and published by MOFCOM. For example, for determining the concentration ratio of the relevant market, MOFCOM relies on the Herfindahl-Hirschman Index ("HHI") like European Union does, but there are no clear criteria on how to exactly apply it. In practice, it is usually accepted that an HHI higher than 2000 might show an effect of limiting or eliminating competition in the relevant market. In the case where Pfizer Pharmaceuticals Ltd acquired Wyeth Ltd, MOFCOM calculated the HHI to be at 2182 after the acquisition, showing an 336 increase; thus MOFCOM made an approval decision with the additional condition that Pfizer shall shed its vaccine business for swine mycoplasmal pneumonia within the territory of the PRC due to the possibility of causing restricting/eliminating effect on competition.

One important feature of anti-monopoly related economic analysis is the enormous amount data required for the review. Therefore, to be able to efficiently respond to a MOFCOM examination, it is recommended for business operators to collect and integrate data in a proactive and timely manner. Especially for industries which are subject to fierce competition, a long examination time may bring difficulties for the management since the market status may change significantly during the course of the examination.

D. Outcome of the review

MOFCOM may provide three distinct decisions following its antitrust review: (a) permission without additional conditions; (b) permission with restrictive conditions; or (c) a prohibition decision.

In the 26 cases of restrictive permissions, all were related to horizontal concentrations, which as a rule may have a more serious influence on market competition than vertical concentrations. Restrictive conditions may come either in the shape of so called constructive conditions or of behavioural conditions. MOFCOM retains a prudent attitude towards using constructive conditions, such as business shedding or asset stripping. Compared with constructive conditions, behavioural conditions are utilized more frequently and usually encompass a greater variety of measures, for instance open compliance, building firewalls between specific businesses, or restrictions on application of variable interest entities ("VIE"). Furthermore, some restrictive conditions may be requested to be executed within a specific period, usually three months, under the supervision of a surveillance trustee (e.g. an authorized auditing firm).

If a business operator subject to the declaration obligation implements an M&A transaction without filing the necessary report and obtaining the approval, it will be fined with a maximum of RMB 500,000; in addition, the transaction will be denied, which means that the business operators may be required to "reverse" the transaction, for instance, to sell back the shares acquired through the denied transaction.

V. Remedies

As discussed in the previous sections, the monopolistic conducts prohibited by the Anti-monopoly Law include both conducts by business operators and conducts by government authorities and their authorised agencies. Based on such differentiation, the remedies available for any persons harmed by monopolistic conducts are twofold. The first type, as against any unlawful conduct by government authorities and its authorized agencies, is the administrative reconsideration and the administrative lawsuit. The second type of remedy is the antitrust civil lawsuit, which allows market participants damaged by monopolistic conduct to sue a business operator responsible for such conduct for compensation of losses suffered.

VI. Conclusion

The implementation of the far-reaching anti-monopoly legislation as well as the recently intensified anti-monopoly investigations against big players in the market, especially where foreign investors are concerned, shows that the incumbent Chinese government has made this project one of its major focuses. Because the Chinese market represents an important source of revenue for many international market players, it is clear that the concentration review process will become a one of the major hurdles in M&A dealings of large companies. For multi-national companies, notification obligations in China may be triggered even in relation to transactions occurring outside of China, if there China business is large enough to exceed a threshold defined by the PRC Anti-monopoly Law.

With regard to other monopolistic practices, such as monopoly agreements, abuses of dominant market positions etc., whether proceedings are initiated effectively lies in the discretion of the relevant government authorities. Within the next few years, it will be interesting to watch whether anti-monopolistic efforts will be directed indiscriminately at domestic and foreign market players active in China or whether the government will apply increased scrutiny to foreign investors.

Due the fact that the NDRC and SAIC will be assigned to supervise and administer all anti-monopoly practices except for the concentration of business operators, jurisdiction conflicts may arise where a monopolistic practice involves both price-fixing and non-price-fixing aspects. So far, the regulatory regime does not specify the outcome when such conflicts do occur, thus the future will show how such cases are addressed by NDRC, SAIC and the courts of law.

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