JONES DAY

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NEW CHINESE ANTI-MONOPOLY LAW

China's National People's Congress ("NPC") finally adopted a new Anti-Monopoly Law ("AML") in August after more than 10 years of drafting. The law will take effect on August 1, 2008.

OVERVIEW

The new AML is a tremendous leap forward for China, bringing it squarely into the modern world of antitrust and competition law. Based loosely on various European models and input from U.S. law, its general structure includes four substantive sections that (1) prohibit certain types of agreements unless they fall within specified exemptions; (2) prohibit certain behavior classified as abuse of dominant market position, providing a framework for determining when dominance exists; (3) establish a broad merger review scheme; and (4) prohibit abuse of government administrative powers restraining competition. A final section sets forth penalties for noncompliance and some miscellaneous provisions, including one that distinguishes between legitimate enforcement and "abuse" of intellectual property rights.

Many aspects, such as specific merger review thresholds, remain to be filled in by detailed implementing regulations or guidelines and actual enforcement practice. The law largely is neutral on its face, but there are some provisions indicating that uniquely Chinese characteristics remain, and international observers will be looking closely to see how China chooses to enforce the new law and specifically at the relative treatment of foreign multinationals and domestic industry. This article centers on some notable features of this new law and its implications for multinational companies with operations in China.

SOME UNIQUE CHINESE CONSIDERATIONS

A number of provisions in the new AML differ in small or large ways from typical competition laws, in particular by evidencing the important socialist heritage of China's largely market economy.

Protecting Public Interest and Promoting the Socialist Market Economy. The declared purposes for the AML include protecting the public interest and

promoting the socialist market economy. Protecting market competition and the legitimate interests of consumers are also listed as legislative purposes in Article 1 of the AML, although language "protecting the legitimate interests of business operators" was removed from the listed purposes in Article 1. Article 4 provides that "the State formulates and implements competition rules compatible with the socialist economy, strengthens and perfects macro regulation and control, and completes a unified, open, competitive and orderly market system."

Regulation of State-Owned Enterprises ("SOEs") Important to the National Economy or National Security. Article 7 provides that, "in industries that implicate national economic vitality and national security, which are controlled by state-owned enterprises, and in industries in which there are legal monopolies, the state shall protect the lawful business activities of those enterprises, supervise and control their conducts and prices for the products and services pursuant to law, protect the interests of consumers, and promote technological progress." In China, many such key industries are controlled by large SOEs, and during the drafting phases there was much speculation that the law would not cover SOEs at all.

However, the second paragraph of Article 7 prohibits SOEs from abusing their dominant positions or legal monopolies to the detriment of consumers. It remains to be seen whether this article is used by the Anti-monopoly Enforcement Authorities ("AMEA") to protect SOEs or rein them in. The published discussion during the second reading by the NPC centered more on how to curb the monopolistic behaviors of SOEs holding lawful monopoly positions rather than on protecting those SOEs. Most discussions indicated that telecommunication enterprises and other SOEs in the public utilities sector were the targets of criticism for behavior such as charging excessively high prices, low-quality services, excessive profits, and harm to the State and consumers. However, which industries "implicate national economic vitality and national security" remains to be defined. Although the Chinese public may want to use the new AML to curb the behavior of such public utility companies, some observers have expressed doubt that AMEA will have the strength or will to challenge those conglomerates.

Trade Associations and Industry Self-Discipline. The new AML is of two minds in handling trade associations, which traditionally often control the behavior of many Chinese industries, particularly those targeted at the export trade. A provision clearly stating that the activities of trade associations shall be governed by the AML had been present in all the drafts submitted to the NPC until it was replaced at the last minute with language in Article 16 stating: "Industry associations shall not organize the business operators in their industry to engage in the monopolistic conducts prohibited by this Chapter." But Article 11, which was added during the NPC's second reading (out of three) in June 2007, provides that "trade associations shall strengthen self-discipline of the industries, provide guidance for enterprises in their industries to compete lawfully, and protect the order of market competition." This reflects competing concerns: On the one hand, trade associations are expected to enhance the overall power and international competitiveness of Chinese industry and may justify export and domestic cartels in the name of responding to competitive pressures from foreign competitors; on the other hand, trade associations are a common instrument for price-fixing, which is understood to raise prices above competitive levels. For example, recent price increases set by the Chinese Instant Noodle Association were heavily discussed in the third review session of the AML, after they were ruled illegal by the National Development and Reform Commission ("NDRC"), which regulates prices in accordance with the Chinese Price Law.

Exemptions for Protecting International Trade, Small- and Medium-Sized Enterprises ("SMEs"), and the Environment. There is no distinction in the AML between conduct that is "hard core" or *per se* illegal and conduct subject to a rule of reason analysis. All horizontal and vertical agreements caught under Articles 13 and 14 may be exempted under Article 15 if they satisfy those exemptions. Some of these exemptions include improving operational efficiency;

enhancing the competitiveness of small and medium SMEs; promoting various public interests such as conserving energy, protecting the environment, and providing disaster relief; mitigating severe decreases in sales or overstocking during economic recession; and protecting "the legitimate interests of international trade and foreign economic cooperation." The latter in particular seems to leave room for preferences to domestic cartels or national champions where perceived necessary to compete on the global stage.

Merger Review Considers Effects on Competitors and on "National Economic Development." Article 27 directs the AMEA, in reviewing mergers and acquisitions, to consider among other factors the parties' market shares and market power; market concentration, and structure; the "likelihood of elimination or restriction of competition in the relevant market as a result of the proposed concentration"; the effect on consumers and other relevant business operators [which could be read to include competitors, customers, and suppliers]; and the "effect on the development of the national economy and public interest."

This language may permit protection of domestic competitors as well as consumers, although elimination of the language from earlier drafts setting forth the "protection of the lawful interests of business operators" as one of the objectives of the AML suggests that may be too pessimistic. But the provision requiring consideration of the effect "on the development of the national economy and public interest" squarely raises the question of whether merger enforcement will be utilized for macroeconomic or even protectionist goals that would better be kept separate from competition issues.

Prohibition on Abuse of Administrative Powers to Restrict Competition. Perhaps most uniquely, chapter five of the AML, which was intermittently removed from and then included in various drafts of the AML—prohibits "administrative monopoly," *i.e.*, when public and administrative government entities abuse their powers to hinder the workings of free markets. Because of its political nature, however, it is too difficult to speculate on to what extent this provision can and will be enforced.

FACIALLY NEUTRAL PROVISIONS THAT SOME FEAR WILL BE USED AGAINST FOREIGN COMPANIES

There are a number of provisions that appear neutral on their face but about which Western commentators have raised concerns that they could be enforced in a discriminatory fashion against foreign companies in China:

Restricting the Purchase or Development of New Technology. Article 13 prohibits agreements between competitors to fix, maintain, or change prices; limit output or sales; allocate markets; restrict the acquisition or development of new technology; jointly boycott transactions; or "other monopoly agreements determined by the AMEA." This largely comports with international practice: Most jurisdictions have similar *per se* rules against price-fixing and "hard-core" horizontal agreements. However, some observers have expressed concern that prohibiting agreements that "limit the purchase of new technology" may restrict the ability of intellectual property rights owners to license their IP rights on terms that may seem reasonable to them but not to potential Chinese licensees or the Chinese government. (Note: a Judicial Interpretation on Adjudication of Technology Contracts in 2005 declared that restrictions on the acquisition of competing technology or development of new technologies can be considered as "illegal monopoly of technology.") The exemptions in Article 15 of the AML may offer some protection, but licensors may find it difficult to satisfy the conditions for exemption, such as that the agreement "enables the consumer to share the benefits derived" from the agreement, and the law appears to place the burden of proof on licensors.

Abuse of Dominance by Selling at "Unfairly High Prices." Article 17 prohibits dominant firms from "selling at unfairly high prices or buying at unfairly low prices." What constitutes "unfair" is not defined. This appears to reflect a continued desire by the government to regulate pricing—although this generally is the province of the NRDC—even in unregulated

markets. It is far broader than typical prohibitions on, for example, predatory pricing, where consideration of the ability of such firms to recoup the costs of predation usually is required. There is no indication of how the AMEA will make such subjective determinations of "unfairness" or whether involved parties will be permitted to present economic evidence of the likely competitive effects (or absence thereof) of any such pricing activities.

Merger Review and Consideration of Effects on the "Advancement of Technology." Article 27 requires the AMEA to consider a proposed transaction's effects on "market entry and technological progress" during merger review, which could raise issues about IP rights as well as other potential barriers to entry. Such provisions reflect the great significance that the Chinese government attaches to IP-related issues even in the anti-monopoly context. Although they are not discriminatory on their face, the fact that the AMEA must consider IP issues when reviewing mergers has raised concerns about potentially excessive regulatory discretion and favoritism towards domestic Chinese industry, especially given that domestic academic and public discourse has been full of complaints about the abuse of IP rights and positions by dominant Western firms. It is possible that the enforcement agencies will consider exclusive or superior technologies owned by foreign companies to be technical barriers in relevant markets.

AML Applies to "Abuses" but Not "Legitimate" Uses of IP Rights. Similarly, Article 55 provides that "This law is not applicable to conducts by business operators to exercise their *legitimate* intellectual property rights in accordance with the IP laws and relevant administrative regulations; however, this Law is applicable to the conduct of business operators to eliminate or restrict market competition by *abusing* intellectual property rights." This very general language appears to present a concept similar to patent misuse under U.S. law, where, for example, a patent holder would not be permitted to seek to leverage its lawful monopoly IP rights to extend them beyond the proper scope of the patent. (The Chinese characters used in the law can be translated as either "abuse" or "misuse.") However, many multinational companies have feared that Chinese antitrust enforcers may be pressured by domestic industry to use this provision to restrain foreign IP rights holders from enforcing their IP rights against Chinese competitors.

ENFORCEMENT DISCRETION AND POWERS

Many of the AML's provisions intentionally utilize broad or vague language, which is intended to be filled in by implementing regulations while allowing ample room for discretionary enforcement and subsequent updating of such regulations. However, this reduces predictability, particularly in a civil law system such as China's that does not rely on case law precedents.

Broad Exemptions, but Must Be "Proven." As noted above, Article 15 contains a large number of potentially overbroad *exemptions* to the general prohibition against monopoly agreements. For example, it permits agreements that have the purpose (even if not the effect) of improving techniques or research and development, upgrading quality, unifying product models and standards, improving the competitiveness of SMEs, mitigating severe decrease in sales volume during recession, and protecting legitimate interests of international trade and foreign economic cooperation, among others.

Businesses seeking to use such exemptions to escape liability under Chapter II of the AML bear the burden to prove that the agreement (1) is for one of the listed purposes in Article 15; (2) will not substantially restrict competition in the relevant market; and (3) will enable the consumers to share the benefits derived from the agreement. These factors appear to be modeled after EU law, but without the element of indispensability, which potentially makes resort to the exemptions too easy. Detailed guidance in the implementing regulations will be needed to avoid creating so much room for competitors to claim exemptions that the law either will be rendered ineffective or will require the regular exercise of administrative discretion, making enforcement arbitrary and unpredictable.

Power to Inspect and Investigate, Seize Files and Records, Access Bank Records. Article 39 of the AML grants the AMEA broad powers in connection with enforcement. These

include, among other things, the powers to investigate and obtain relevant evidence, including documents, accounting records, electronic data, and bank account records, and the power to conduct on-premise inspection of the place of business and other places. The AMEA does not need a court order for search, seizure, and other enforcement actions.

Penalties for Noncompliance. For violations against monopoly agreements and abuse of dominant position, the AMEA has the power to fine companies between one and 10 percent of total annual turnover plus the confiscation of any illegal gains. Detailed penalty rules in subsequent implementing regulations will be needed to provide guidance on whether such sales will include only those in relevant markets or all sales by a violator, and how the level of punishment will be determined. For unauthorized concentrations or transactions, fines are fixed at less than RMB 500,000 (an amount that may not be a sufficient deterrent), but the AMEA also has the power to order the reversal of any improper and unauthorized transactions.

Civil Liability for Damages and the Possibility of Private Litigation. Article 50 states that violators "shall bear civil liabilities" where their monopolistic conduct causes losses to aggrieved parties. This vague provision is not clear about how or under what circumstances injured parties may recover from violators for anticompetitive conduct, but there is much speculation that this will permit private enforcement actions in the Chinese courts based on the AML. Already, even before the passage of the AML, there have been some recent cases in which private litigants have sought to recover for alleged violations of other competition-related provisions in existing laws, including prominent lawsuits against Sony and Intel. It can be expected that the AML will be used by domestic enterprises as a weapon against large foreign competitors, but it also may be possible for Western companies to use the AML to level the competitive playing field against dominant Chinese firms or trade associations.

Anti-Monopoly Enforcement Agencies. Article 9 provides that the State Council shall set up the Anti-Monopoly Commission ("AMC"), which will be responsible for organizing, coordinating, and supervising AML-related activities. The AMC is a consultation and coordination body and has no substantive enforcement powers. The functions of the AMC mainly involve formulation of competition policies and guidelines, coordination of enforcement activities, and evaluation of competition conditions in various markets. The AMC itself is a compromise between the outcry for one unified enforcement agency and the maintenance of the existing division of powers among different authorities under the State Council.

There is no provision detailing the structure of the Anti-Monopoly Enforcement Authorities, but many view the vagueness of these AML provisions as an acknowledgement of the concurrent enforcement of the AML by three existing government agencies: the National Development and Reform Commission ("NDRC") in charge of monopoly agreements (particularly price-fixing), the State Administration of Industry and Commerce ("SAIC") in charge of abuses of dominant position, and the Ministry of Commerce ("MOFCOM") in charge of merger review.

The relationship between AMEAs and industry-specific regulators also is not clear. In previous drafts, industry/sector regulators were expressly responsible for anti-monopoly violations within their own sectors in accordance with other laws and regulations and were only required to report the outcomes of their cases to the AMC. This provision later was deleted, possibly providing the basis for more centralized oversight by AMEAs.

Note that Article 31, which mentions a separate and widely reported national security review presumably along the lines of U.S. CFIUS review, does not specify that the AMEA will conduct that national security review as part of the competition analysis of a proposed transaction.

Finally, the AML requires the AMEAs to make public their decisions to block or condition transactions after merger review. This provision, which has been in all the drafts reviewed by the NPC, should provide better transparency for the merger review process.

OTHER IMPORTANT PROVISIONS

Dominance Requires Consideration of Multiple Factors, With Market Shares Providing Only a Rebuttable Presumption. Perhaps the greatest concern expressed by MNCs about earlier drafts of the AML was about presumptions of dominant market position based on market share. A new paragraph finally was added to Article 19 to allow the alleged dominant firm to produce countervailing evidence to rebut the presumption. Article 18 now further prescribes a number of factors to be considered when determining dominant market position, including market share, competition condition in the relevant market, ability to control sales market or raw material purchase market, the financial status and technical conditions of the business operator, and the ease of entry.

Prohibitions on Vertical Restraints. Article 14 prohibits both fixing resale price and restricting minimum resale price. The AML does not expressly prohibit any other types of vertical restraints (except for certain unjustified tying arrangements, price discrimination, and other restrictive trade practices, which are prohibited as abuses of dominant market position when carried out by dominant firms). However, a catch-all clause reserves to the AMEA the power and discretion to designate other "monopoly agreements" under this category. Such vertical agreements also can be exempted by Article 15. It remains to be seen whether and to what extent efficiency and other legitimate business justifications may suffice to justify other vertical restrictions if they are deemed to violate Article 14.

Leniency Available. The AML provides that the AMEA "may" reduce or exempt the penalty if a company reports monopoly agreements and provides material evidence to the AMEA on its own initiative. Unfortunately, this article does not specify whether leniency will be granted, the specific conditions to be met for leniency, or the corresponding reduction of penalties. Those uncertainties, if not clarified in more detailed enforcement rules, will make it difficult for companies involved in cartels to make decisions about reporting such behavior and thus hinder the intended function of such a leniency doctrine.

Procedural Hurdles for Merger Review. Under Chapter IV of the AML, the parties to a covered transaction (which remains to be defined in regulations, along with the specific filing requirements) must wait 30 days (MOFCOM's current practice is to calculate the period with calendar days) after notification before they can close a reported transaction. This makes express a requirement that is generally understood but remains unwritten in existing merger review practice under the Foreign M&A Regulations as administered by MOFCOM and SAIC. The AMEA may, during this preliminary review period, decide to initiate further review, which normally must be completed within 90 *additional* days from the date of its decision to further review the transaction. Furthermore, the AMEA may request an extension of up to 60 *additional* days for its review if the parties consent, if the materials submitted by the parties are "inaccurate," or if there are significant changes of circumstances. All of this means that transactions subject to second-stage investigations could require as much as 30 + 90 = 120 days (roughly 16 weeks or four months) for clearance, and perhaps even more time if the parties' documents or submissions are found to be "inaccurate."

Administrative Review Before Court Challenges to Merger Decisions. Article 53 requires that the decisions by the AMEA to prohibit or permit concentrations first shall be subject to an administrative reconsideration before lawsuits can be filed with a court challenging the decisions. In contrast, when challenging other decisions by the AMEA, the parties may choose to either apply for an administrative reconsideration or directly file an administrative suit with the courts.

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Many outsiders fear that Chinese anti-monopoly enforcers will be pressured to apply the new AML unfairly—*e.g.,* against foreign multinationals, in favor of domestic protectionism, and against IP rights holders. Certainly, the law provides at least some room for them to do so. However, most indications favor the opposite result, and the new AML is a tremendous accomplishment for China that is more likely to be a valuable tool and protection for multinationals as well as domestic companies to ensure healthy competition in the Chinese market. The text of the law, the great pains that the Chinese government has taken to put it into place, and the long preparation period (11 months) between passage of the AML and its effective date lead one to expect that enforcement of the AML will conform to international practices. Chinese anti-monopoly enforcement is likely to follow a long learning curve, but it appears to be headed in the right direction from the start.

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