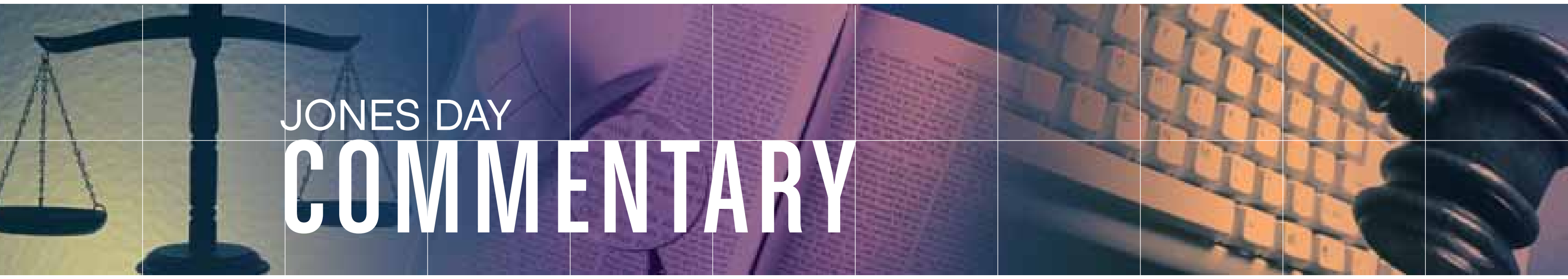
NOVEMBER 2011



LOOKING BACK AND LOOKING FORWARD AFTER THREE YEARS OF ANTITRUST ENFORCEMENT IN CHINA

China's antimonopoly law ("AML") came into effect in August 2008, after more than a decade of consideration. Even if China's antitrust regime is still in its infancy, it is increasingly a significant concern for Western companies, particularly given the lack of transparency surrounding the antitrust agencies and the resulting unpredictability.

On the merger review side, China rapidly has become a significant regulatory obstacle for both Chinese and global M&A transactions. Relatively low turnover thresholds require many transactions to be filed in China, even if there is little connection to China, and the increasingly long timeframe to obtain approval has delayed closing numerous cross-border deals. The introduction of a national security review system for the acquisition of domestic companies or assets may add yet another layer of difficulty.

The enforcement of the nonmerger provisions (against cartels and abuse of a dominant position) has been relatively less active and visible. However, the agencies have now finalized their enforcement guidelines and slowly are beginning to use their powers, including in several noteworthy enforcement actions against large multinational and Chinese state-owned enterprises.

This *Commentary* looks at the most significant developments in AML enforcement since its entry into force and what companies doing business in China may expect in the years ahead.

MERGER CONTROL

The AML has introduced a mandatory premerger approval process for any transaction that involves parties of a certain size. These thresholds are relatively low, starting at US$63 million of revenues in China for each party to the transaction. Hence, any global merger of two, even offshore, companies with minimal sales in China is reportable under the AML.

Reportable transactions must be notified to the Ministry of Commerce ("MOFCOM"). There is no short-form or expedited procedure for mergers with little impact on competition law. As soon as MOFCOM has formally accepted the notification (which invariably happens only after one or two rounds of additional questions), the formal procedure will start. The review may include three phases of 30, 90, and 60 days, respectively. MOFCOM does not need to justify why it moves a case to a subsequent phase and is understood frequently to do so simply because of its own timing, capacity, or procedural constraints. (Compare this to the European Union, where the Commission may put a case into a phase II review only if it has "serious doubts" about the transaction, and the United States, where the agency staff generally will recommend a "second request" only if it has tentatively concluded that the transaction may create competitive problems.)

MOFCOM has reviewed 267 cases as of June 2011. The only decisions that are made public are those prohibiting a transaction (one so far) or imposing remedies (nine so far).

Timeframe for MOFCOM Approval. The pre-acceptance phase (the phase preceding the formal acceptance of the case, during which MOFCOM may ask follow-up questions) has significantly expanded, from two to four weeks on average. It is not uncommon for merging parties to have to respond to two sets of additional questions from MOFCOM before the notification is deemed complete and the 30-day phase I period can start. The number of additional rounds of questions in the pre-acceptance phase does not seem to be correlated to the level of detail of the draft notification.

Most, if not all, cases are put into phase II even if a transaction does not present significant competition law issues. MOFCOM does not seem to have sufficient resources at this stage to handle incoming merger cases within the 30 days of phase I. Thirty days also does not seem to be sufficient in most cases for MOFCOM to gather all internal approvals and receive feedback from other ministries such as the National Development and Reform Commission ("NDRC") or the Ministry of Industry and Information Technology, which are routinely required to submit comments as part of the merger review process.

Fortunately, merging parties can expect clearance of mergers with relatively little impact on concentrations within the first four to eight weeks of the second phase, which could last 90 days.

Given that merging parties generally first file in jurisdictions such as the U.S. or EU before turning their attention to China, MOFCOM's approval of global deals frequently lags that of the other major jurisdictions. It is therefore essential for the merging parties to plan ahead and file their notification in China in parallel to other jurisdictions.

Emphasis on Effects of Mergers in China. Even if the relevant market is worldwide, MOFCOM will ask the merging parties to provide a detailed description of the Chinese market, including market shares (not always easily available) and the effect on Chinese customers and Chinese competitors.

MOFCOM generally focuses on the effect a proposed merger may have on the Chinese market, paying particular attention when the relevant products are viewed as important to the development of the Chinese economy. For example, in a merger between two Russian potash (fertilizer) producers, MOFCOM imposed a remedy aiming at securing the availability of supply to Chinese customers, rather than focusing on whether the global potash market would remain sufficiently competitive (*see, e.g., Jones Day Antitrust Alert*, "China Approves Merger between Russian Potash Producers but Requires They Continue to Supply the Chinese Market," June 2011).

National Security Review. In addition to the competition review, China recently has put in place a new national security review process, which provides for review and potential rejection of the acquisition of a Chinese company by foreign investors where the acquisition could affect national security (*see Jones Day Commentary*, "China Publishes Final Rules on the National Security Review of Foreign Investment in Chinese Companies," September 2011). It applies to acquisitions in a wide range of industry sectors, including defense, agriculture, energy, and transportation. The review is to be conducted by a joint ministerial panel that includes MOFCOM, the NDRC (the price and industrial policy regulator), and other relevant agencies. There remains no clear indication of what sorts of transactions are likely to be rejected on national security grounds. However, the PRC government takes a broad view of "national security," to include, for example, economic security, social order, and R&D capabilities relating to key technologies.

The national security review rules leave great discretion in the hands of government agencies. Whether these rules will constitute another serious obstacle for foreign companies doing business in China will depend on how they are applied in practice. So far, no decision taken under the new procedure has been published.

ABUSE OF DOMINANCE

The AML prohibits abuse of a dominant position, analogous to "monopolization" in the U.S. system, such as predatory pricing, unfair pricing, tying, and refusals to deal. Both the NDRC and State Administration of Industry and Commerce ("SAIC") have issued guidelines on how they intend to interpret these provisions of the AML (*see Jones Day Antitrust Alert*, "China Issues Rules for Price-Related Antitrust Enforcement," January 2001, and "China's SAIC Publishes its Final Anti-Monopoly Law Rules," January 2011).

So far, enforcement of the AML's abuse of dominance provisions has been primarily by courts rather than through the administrative agencies. According to data released by the Supreme People's Court, courts had accepted 43 first-instance civil AML cases as of the end of 2010. Courts have proven relatively conservative in their decision-making. There were two widely reported cases, *Sursen vs. Shanda* and *TRISC vs. Baidu*, which were filed right after the AML took effect (*see Jones Day Antitrust Alert*, "New Chinese Court Developments Provide Insights into Anti-Monopoly Law," November 2009, and "Second Chinese "Dominance" Decision Issued Under the China Anti-Monopoly Law," January 2010). Both judgments reiterated that AML does not prohibit the existence of a dominant market position itself, only conduct that constitutes an abuse of such a dominant position. The courts also required a high level of proof of a dominant market position to support a claim.

The courts demanded substantial evidence and refused to base a finding of a dominant position solely on media reports or the parties' own statements about market shares. They took a skeptical view of third-party market share reports if the underlying calculation method was not disclosed, so that the court could make its own judgment of whether the market shares calculation was scientific and objective. Both courts appeared open to considering practical business justifications and ultimately concluded that the alleged abusive conduct was justified. In its *Baidu* decision, the Beijing No. 1 Intermediate Court appeared to require proof of anticompetitive effects, "an injury on the competition order," to sustain a finding of abuse of dominance.

Partly due to the setbacks of the first waves of antitrust cases and the relatively high burdens of proof placed on complainants and lower burdens on defendants, in April 2011, the Supreme People's Court published a draft judicial interpretation regarding AML civil suits, to clarify the burden of proof and other procedural issues of antitrust civil suits (*see Jones Day Antitrust Alert*, "China's Supreme Court to Set Framework for Antitrust Litigation," May 2011).

On the administrative side, there have been only a handful of reported decisions, notably the investigation by the NDRC into tying practices by the Hubei Salt Industry Group, which was suspended after the Group committed to refrain from tying. More significantly, the NDRC announced in November 2011 that it was investigating China Telecom and China Unicom for alleged abuse of dominant position in the broadband market. This announcement is significant, as it indicates that enforcement agencies are ready to take action against state-owned enterprises, which still enjoy monopolies in many industries.

CARTELS

Cartel activity, such as price fixing and market allocation, violates the AML and also other Chinese legislation, such as the PRC Price Law. So far, there have been only a few cartel decisions, and most seem to have been taken on the basis of the Price Law rather than the AML itself. Both the NDRC and SAIC have issued leniency policies in 2011 (*see Jones*

Day Commentary, "China's New Leniency Procedure in Cartel Investigations," January 2011), which offer protection from penalty in exchange for cooperation by a cartel participant. The details of these policies at this point are unclear, and it remains to be seen whether they will lead to more cartel enforcement in China.

The NDRC has published several enforcement actions against local cartels among Chinese companies (*see Jones Day Antitrust Alert*, "Chinese Pricing Enforcers Impose Higher Fines as New Rules Proposed," July 2010). The largest fine so far imposed by the NDRC, about US$1 million, concerned price fixing and market allocation between two pharmaceutical companies in the Shandong Province, in relation to the supply of promethazine hydrochloride. The NDRC also imposed a fine of US$313,000 on Unilever under the Price Law for spreading information about price increases and disturbing market order. In its April 2011 press release, the NDRC expressly prohibited "maliciously spreading information about price increase to test the market and increase price with competitors in tacit collusion." SAIC published its first cartel decision under the AML in 2011. It imposed a US$31,000 fine on a trade association of concrete manufacturer in the Jiangsu Province for market allocation.

WHAT TO EXPECT IN THE FUTURE

More Private Antitrust Litigation. So far, private litigation has been surprisingly active, more than some western observers predicted, and it is likely to receive a boost when the People's Supreme Court releases its final guidelines on private antitrust litigation. Indeed, if the final guidelines are adopted along the lines of the draft release for comments in April 2011, plaintiff's burden of proof would be made easier (*see Jones Day Antitrust Alert*, "China's Supreme Court to Set Framework for Antitrust Litigation," May 2011). Given that China is a very litigious country (more IP lawsuits than any other country in the world), this could pave the way for significant private antitrust litigation.

Increased Cartel Enforcement. The existence of a robust leniency program has been a catalyst for cartel enforcement in many other jurisdictions, in particular the U.S. and EU. The leniency regime put in place by the PRC Anti-Monopoly Agencies presents some uncertainties. The most important one is whether a leniency applicant, upon disclosing the prescribed evidence to the authorities, will automatically receive leniency, or whether the authorities retain discretion enabling them to refuse leniency. The Anti-Monopoly Agencies have not yet clarified this point. Obviously, increasing companies' confidence that they actually will receive leniency will clear the way for more leniency applications and lead to more cartel enforcement.

Longer Delays in Merger Review. MOFCOM's resources for conducting merger reviews seem to be insufficient to tackle the increased flow of merger notifications. Unless MOFCOM is able to significantly increase its resources in the short term, companies are likely to face increasing delays in getting their mergers cleared in China.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Peter J. Wang
Beijing
+86.10.5866.1111
pjwang@jonesday.com

Sébastien J. Evrard
Beijing
+86.10.5866.1112
sjevrard@jonesday.com

Yizhe Zhang
Beijing
+86.10.5866.1111
yzhang@jonesday.com