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# COMMENTARY

# New China Antitrust Guidance on Restrictive Business Agreements

Many horizontal collaborations among competitors, and most vertical supply or distribution arrangements, have both procompetitive and anticompetitive effects. Exceptions, of course, are price fixing and other "hard-core" or "per se" illegal antitrust violations, which are considered inherently anticompetitive. Until recently, the Chinese Anti-Monopoly Law ("AML") provided little guidance for companies operating in China about how to evaluate and balance those procompetitive and anticompetitive effects so as to assess an agreement's compliance with antitrust law. Recent guidance will help in counseling companies doing business in China.

In effect since 2008, the AML prohibits certain horizontal and vertical agreements that may restrict competition, so-called "monopoly agreements." At the same time, monopoly agreements may be exempted from the AML when three conditions are met:

- The agreement has one of several enumerated beneficial purposes, namely to improve technology or R&D for new products; upgrade product quality, reduce costs, or improve efficiency; unify product specifications and standards, or implement production specialization; improve efficiencies or the competitiveness of small and medium enterprises; or save energy or protect the environment;
- The agreement will not substantially restrict competition; and
- Consumers will share the benefits.

This interplay between monopoly agreements and potential exemptions has often been viewed as a sort of "rule of reason" framework within the AML. But there had been little specific guidance on how this framework might be applied. Nor are there any published decisions from the Chinese anti-monopoly enforcement agencies to shed light on actual practice.

This dearth of guidance began to change last year with the issuance of intellectual property guidance by the State Administration for Industry and Commerce ("SAIC"), one of China's three antitrust agencies. The SAIC Rules on the Prohibition of Abuses of Intellectual Property Rights that Eliminate or Restrict Competition ("SAIC IP Rules") contain "safe harbor" provisions for agreements in certain low-market-concentration contexts. Since then, the National Development and Reform Commission ("NDRC"), another antitrust agency, has issued for public comment several draft guidelines on AML exemptions. These draft guidelines flesh out how the AML exemption process should work going forward.

Once finalized, these guidelines are expected to be promulgated by the Anti-Monopoly Commission ("AMC") of the Chinese State Council and become binding on all three antitrust agencies (the third being the Ministry of Commerce or MOFCOM, which handles merger review).

The other five draft guidelines so far issued by NDRC on behalf of the AMC are the Guidelines on Prohibiting Abuse of Intellectual Property that Eliminates and Restricts Competition ("Draft IP Guidelines"), Guidelines on Anti-Monopoly in the Automobile Industry ("Draft Automotive Guidelines"), Guidelines on Leniency, Guidelines on Commitments of Undertakings, and Guidelines on Calculation of Illegal Gains and Penalties.

Most recently, in May 2016, the NDRC issued draft guidelines on the General Conditions and Procedure for Exemption of Monopoly Agreements ("Draft Exemption Guidelines"), which directly address the issue of exemption under Article 15 of the AML.

## Overview of the Guidelines

Most of the Draft Exemption Guidelines address the procedure for a company to apply for an exemption when one of the anti-monopoly agencies is investigating it for having made an anticompetitive agreement. This includes the process for application, the materials that must be submitted, factors to be considered by the agency, publication of exemption decisions, and details about the investigation process, including the collection of opinions and data from other government agencies and third parties. Articles 7-9 of the Draft Exemption Guidelines provide more details regarding the substantive exemption assessment.

**Self-Assessment and Consultation.** The overall approach to exemption contemplated by the Draft Exemption Guidelines appears similar to that taken by the European Commission. Companies are encouraged to engage in "self assessment" and are not required to apply to the authority in advance for an exemption, but they may defend themselves based on an exemption after the authority initiates an investigation. The Draft Exemption Guidelines do provide for an "exemption consultation" procedure, similar to the business review process in the United States. However, the consultation procedure appears to be available only under the unusual circumstance where the agreement may affect competition in multiple jurisdictions and the parties also plan to apply for exemption elsewhere or consultation is filed by a nationwide industry association regarding an agreement with issues of industrywide significance.

**Application for Exemption.** Under the Draft Exemption Guidelines, once an agreement is being investigated by one of the antitrust agencies, the parties to the agreement can file an application for exemption along with the relevant supporting documents. It is not clear from the draft guidelines whether the antitrust authority needs to prove the anticompetitive effect of the agreement before the parties should file an application exemption. That is, how can an investigated party know whether its agreement falls under the monopoly agreement prohibitions of AML Articles 13 and 14 and therefore that it should apply for exemption? In practice, the investigated party may know only when the agency orally tells it that the agency has "competition concerns" about the agreement, shifting to the party the decision whether to apply for an exemption.

## Agreements that May Benefit from the Guidelines

Theoretically, all monopoly agreements caught under Articles 13 and 14 of the AML are eligible to qualify for exemption under Article 15. As a practical matter, price fixing or other hardcore violations should never be exempted.

**Safe Harbor Provisions.** Agreements covered by a safe harbor would benefit most from the various draft guidelines, because if enacted, the guidelines would provide confidence that the conduct would not be challenged.

None of the Draft Exemption Guidelines provides a safe harbor provision. But the SAIC IP Rules and the Draft IP Guidelines and Draft Automotive Guidelines both contain such provisions and provide useful guidance.

For example, the SAIC IP Rules have safe harbors for agreements involving: (i) competitors with combined market shares of no more than 20 percent of the affected relevant markets (or in markets with at least four other independently controlled substitutable technologies available at reasonable cost); or (ii) companies in vertical relationships and none having more than a 30 percent market share (or where at least two other independently controlled substitutable technologies are available at reasonable cost).

Similarly, the Draft IP Guidelines indicate that, absent hardcore violations specifically proscribed under Article 13 or 14, IP-related agreements are presumed to satisfy the conditions for exemption if they involve competitors with combined market shares below 15 percent or vertical relationships in which no party has a share exceeding 25 percent.

Finally, the Draft Auto Guidelines provide a safe harbor for vertical territorial restrictions and customer restrictions if no company has more than a 25-30 percent market share and the agreement does not prohibit passive sales or cross-selling between distributors.

It appears reasonable to conclude that, with the exception of price fixing or other collusion and resale price maintenance ("RPM"), the antitrust risk for other types of agreements will be low absent a dominant market position. There may even be a presumption that the Article 15 exemption applies if the combined market share is less than 15 percent in a horizontal relationship or less than 25 percent in a vertical relationship. Agreements not covered by the safe harbors will be evaluated for exemption on a case-by-case basis, as discussed next.

## How to Conduct Self-Assessment for Compliance

For all monopoly agreements falling outside safe harbors, the parties still may seek to prove that the agreement meets the three conditions set out by AML Article 15. The Draft Exemption Guidelines' Articles 7-9 set out the factors that will be considered by the agencies in determining whether to grant an exemption based on the three conditions.

1. **Beneficial purposes and indispensability.** Article 7 of the Draft Exemption Guidelines requires proof of specific form and effect in realizing one of the beneficial purposes listed in Article 15. Moreover, there must be a causal link between the agreement and the claimed procompetitive purposes plus proof the agreement is needed to realize such purpose. It appears that the Exemption Guidelines have added a requirement of "indispensability" for exemption, an element that is not spelled out under the AML itself.
2. **No substantial effect on competition.** The agencies also will examine whether the agreement substantially restricts competition in the relevant market. From the Draft Exemption Guidelines and other draft guidelines, it appears that the factors to consider are essentially the same as those used to determine whether one company has market power or a dominant market position. The agencies will look at market share and also other factors such as ability to control the downstream or upstream market, financial or technical strength, the level of reliance of their contractual counterparties on the products or technology involved, barriers to entry, and the like.
3. **Consumer's share in the benefit.** That customers will share the benefits of the agreement can be proved by evidence that the agreement will produce innovation in products or services, an increase in output volume or the variety of products, an increase in quality or safety, lower prices, greater convenience for customers, or other procompetitive benefits that customers will enjoy.

## Unclear How to Remedy an Anticompetitive Agreement

The draft Exemption Guidelines Article 12 provides for only two decisions after the authority investigates and finds a prohibited monopoly agreement: grant an exemption or refuse an exemption and impose a penalty for AML violation. The draft Guidelines provide that the agency will, before its notice of penalty decision, inform the investigated company of the right to apply for an exemption—presumably including the facts and legal basis for potential violation.

It would be beneficial for businesses if the antitrust authorities had greater flexibility to remedy anticompetitive effects while preserving the social and economic benefits of an otherwise prohibited agreement. In other words, it would be better for the authorities to have the power to modify an underlying agreement rather than making an absolute "yes or no" decision.

This flexibility could be achieved through a number of ways under the AML, including by granting the powers to (i) recognize an exemption subject to conditions (something that is not explicit in, but may be implied from, AML Articles 44 and 45) or (ii) suspend or terminate an investigation if the parties agree to remedy the anticompetitive effect under AML Article 45. It would be helpful if the final Exemptions Guidelines would clarify whether an agreement subject to Article 45 commitments, if approved by the agency, could be granted an Article 15 exemption or otherwise avoid a penalty decision.

Article 13 of the draft Exemption Guidelines provides that the agency will publish its exemption decisions. Publication will assist the business community and legal counsel in understanding the types of conduct that might qualify for exemption and providing guidance on self-assessment in the future.

## Conclusion

There is as of yet no published precedent of a monopoly agreement that has been granted exemption under the AML. This is partly due to the fact that so far there has been little enforcement of the AML except involving collusion and RPM, which generally will not qualify for exemption. However, the recent Draft Exemption Guidelines, IP Guidelines, and Automobile Industry Guidelines confirm the apparent willingness of the antitrust authorities to grant exemption or even a block exemption, if the competitive benefits of an agreement outweigh the potential anticompetitive effects. The draft Guidelines also provide detail and guidance designed to encourage companies to engage in self-assessment of any restrictive agreement that may give rise to competition concerns. Some of the draft Guidelines have been submitted to the State Council for review, possible change, and approval.

## 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/contactus/.

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