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WHITE PAPER

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China Publishes Long-Awaited Anti-Monopoly Guidelines for the Automobile Industry

The Anti-Monopoly Bureau ("AMB") of China's State Administration for Market Regulation ("SAMR") recently released four sets of long-awaited anti-monopoly guidelines, including the Anti-Monopoly Guidelines on the Automobile Sector ("Guidelines"). While the Guidelines are significant for companies in the automobile industry, companies in other industries should pay close attention to the Guidelines too, as they provide insights into SAMR's positions on certain key antitrust issues such as relevant market definition in aftermarkets, exemption applications, and agreements related to sales and distribution practices.

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The Anti-Monopoly Bureau ("AMB") of China's State Administration for Market Regulation ("SAMR") recently published four sets of guidelines under the Anti-Monopoly Law ("AML") that cover leniency for cartel conduct, settlements (known as the commitments mechanism), intellectual property rights, and the automobile sector.

This *White Paper* highlights the key takeaways from the Anti-Monopoly Guidelines on the Automobile Sector ("Guidelines"). Despite being specific to the automotive industry, the Guidelines also may provide insight into the agency's views on issues common to other industries and also help non-automotive companies to assess potential antitrust risks from their commercial conduct.

RESTRICTIONS IN AFTERMARKETS SALES ARE SUBJECT TO STRICT SCRUTINY

A primary focus of the Guidelines is how to assess whether there are automobile brand-specific markets for aftermarket parts and services. As a starting point, the Guidelines explain that the automobile manufacturing market as a whole is competitive. However, the Guidelines explain that automobile manufacturers that do not hold a dominant market position in automobile manufacturing may nevertheless possess market power (and therefore be deemed dominant) in aftermarkets for parts and services for their automobiles due to so-called "lock-in" effects. The "lock-in" effect is an argument that a purchaser of a primary product or service has no alternative but to purchase aftermarket parts or services from the same supplier or its designee.

Accordingly, automobile manufacturers must be careful to avoid behavior that may constitute an abuse of a dominant position in aftermarkets, such as:

- Preventing resellers or repairers from purchasing aftermarket spare parts, particularly compatible parts or original parts obtained through channels other than the brand manufacturer (such as parallel imports);
- Forcing resellers or repairers to adhere to unreasonable targets for sales, varieties, or stocking quantities of aftermarket spare parts;
- Preventing spare parts suppliers, resellers, and repairers from selling aftermarket spare parts to other customers (including other automobile distributors and end users); and
- Restricting the availability of technical repair information, limiting diagnosing and repair tools, or setting unfairly high prices for technical repair information.

Although the Guidelines leave some room for an automobile manufacturer to prove that it does not have a dominant market position in parts and services aftermarkets for its own brand, SAMR appears to take an aggressive approach toward automobile aftermarkets by prohibiting the above conduct and presuming market power in those aftermarkets.

However, in a 2012 civil antitrust lawsuit, a provincial High Court held that the plaintiff failed to prove that Dongfeng Nissan was dominant in the aftermarket for spare car door lock parts for its own brand of cars. The evidence showed that market entry barriers were low and that customers could substitute comparable parts from third-party manufacturers that had the same functions and characteristics.[1]

Unlike the SAMR Guidelines, the U.S. agencies have said that they and the U.S. courts "very rarely" conclude that the market is limited to the product of a single manufacturer.[2] Moreover, the U.S. agencies and courts are unlikely to find liability under a "lock-in" theory if a manufacturer lacks market power in the primary market, and consumers have alternatives in the foremarket.[3] Courts have been reluctant to find monopoly power if aftermarket costs are transparent to customers because purchasers take into account the cost of aftermarket products and services when making their initial purchase (so-called "lifecycle" pricing), and there are not unexpected changes to aftermarket policies, or if switching costs are low.[4]

In the European Union ("EU"), while abuse of dominance claims may be possible in specific circumstances, EU law exempts vertical agreements related to motor vehicle aftermarkets through a regulation that applies the general vertical block exemption to automobile aftermarkets. To qualify for the exemption, each party to the agreement must have a market share that does not exceed 30% and the agreement must not contain any prohibited "hardcore" restrictions.[5]

RESALE PRICE MAINTENANCE REMAINS HIGH-RISK CONDUCT IN CHINA, WITH LIMITED INDIVIDUAL EXEMPTIONS

An agreement between an automobile manufacturer and a distributor to set or maintain the price at which the distributor will resell products, known as resale price maintenance ("RPM") or vertical price fixing, is high-risk conduct and a prominent target for antitrust enforcement in China. SAMR's approach to RPM in the Guidelines is consistent with its enforcement practice, detailed in a prior *White Paper*, in which it presumes that RPM is an anticompetitive violation of the AML. In contrast, in private RPM civil lawsuits, a plaintiff has the burden to prove that RPM has an anticompetitive effect, which makes it harder to prevail against a supplier with relatively low market shares.

Although SAMR disfavors RPM, the Guidelines specify several circumstances in which RPM may be exempted from enforcement (the "individual exemption"):

1. **"Distributor" is merely an intermediary.** An automobile manufacturer may directly negotiate and agree to a selling price with an end customer if the "distributor" is responsible only for supporting various transaction processes such as invoice issuance, delivery, and payment collection. The distributor must assume very limited costs and risks in connection with the sale.

2. **Sales via e-commerce platforms.** Similar to exemption 1, an automobile manufacturer may sell its products at uniform prices through e-commerce platforms for a certain period of time and directly enter into transactions with unspecified end customers, so long as the distributor merely provides logistic support for those transactions.

3. **Government procurement.** Government procurement programs typically require automobile manufacturers and their distributors to submit joint bids that propose a specific retail price to the government customer.

4. **Short-term new energy vehicle ("NEV") sales.** For a nine-month period following the launch of an NEV model (i.e., vehicles powered entirely or mostly by new energies such as electric cars), an automobile manufacturer may determine its distributors' resale prices. The Guidelines note that this exemption period may be adjusted in the future depending on the developments in NEVs and the relevant technologies.

While the exemption for short-term sales of NEVs seems to be justified by potential procompetitive effects of RPM (i.e., promoting new products), the other individual exemptions appear to reflect factual circumstances to which RPM arguably may not apply. In exemptions 1 and 2, either (a) there is no "resale" by the "distributor," which functions merely as a facilitator or agent, and/or (b) the manufacturer has directly participated in the negotiation and set the price to the end customers.

The Guidelines recognize only very limited circumstances for individual exemptions for RPM under Article 15 of the AML. In practice, SAMR is not receptive to arguments that RPM does not restrict competition or that it has procompetitive effects.

SUGGESTED RETAIL PRICES AND MAXIMUM RESALE PRICES ALSO REQUIRE CAUTION

Under the AML, suggesting a retail price or setting a maximum resale price—whether for complete vehicles, aftermarket spare parts, decoration accessories, or maintenance services—should be low-risk conduct, because Article 14 prohibits only the fixing or setting of minimum resale prices. However, the Guidelines make clear that an automobile manufacturer can be liable for de facto RPM (consistent with SAMR's long-held enforcement views) if most or all distributors implement the suggested or maximum resale prices.

Similarly, in the EU, recommended prices or maximum resale prices are lawful unless that conduct results in a fixed or minimum sale price as a result of pressure or incentives to impose such a price. In contrast, under U.S. federal law, it is lawful for a manufacturer to announce a suggested resale price and unilaterally refuse to deal with/unilaterally terminate noncomplying dealers. Also under U.S. federal law, maximum RPM, like minimum RPM, receives rule of reason treatment. However, a small number of U.S. states still treat at least minimum RPM as per se unlawful.

LIMITED SAFE HARBOR ("PRESUMPTIVE EXEMPTION") FOR TERRITORIAL AND CUSTOMER RESTRICTIONS

The Guidelines also establish a safe harbor exemption under Article 15 of the AML for certain types of territorial and customer restrictions when the automobile manufacturer has a share less than 30% in the relevant market[6] ("presumptive exemption"). Under this exemption, a qualifying automobile manufacturer may:

- Restrict distributors from carrying out sales activities outside their own business premises;
- Restrict distributors from making any sales to a certain territory or group of customers that the automobile manufacturer allocated exclusively to another distributor;
- Restrict wholesalers from selling products directly to end customers; and
- Restrict distributors from selling the manufacturer's spare parts to customers who will manufacture competing products.

If a manufacturer's market share is less than 30%, SAMR presumes the restrictions noted above do not have an anticompetitive effect. However, if there is contrary evidence that shows a severe restriction on competition, SAMR may decide that the exemption is not applicable. Thus, a company considering the above-noted practices should evaluate whether it qualifies for the presumptive exemption as well as the risk that SAMR might reject its application.

The Guidelines also highlight that the presumptive exemption does not apply to three types of territorial or customer restrictions, regardless of market share:

- Restricting passive sales (i.e., responding to unsolicited requests from individual customers or general advertising or promotion that reaches another distributors' territory), including online sales, which are typically considered to be passive sales;
- Restricting cross-supply between distributors; and
- Restricting distributors from selling to end customers spare parts that are "necessary" for aftermarket maintenance services.

In allowing cross-selling and passive sales, SAMR's goals appear to be enhancing intrabrand competition among distributors and prohibiting agreements that might be perceived to limit the availability of maintenance services and spare parts sales from different sources.

OTHER VERTICAL RESTRICTIONS SUBJECT TO CLOSE SCRUTINY

In addition to the specific types of vertical agreements mentioned above, the Guidelines also state that "other vertical monopoly agreements" are subject to rule of reason analysis, including but are not limited to:

- An automobile manufacturer requires that all aftermarket maintenance and repair services covered by an end-user warranty must be provided by authorized service networks or third parties that the manufacturer designates;
- An automobile manufacturer restricts its maintenance network from providing aftermarket repair and maintenance services for parallel imported vehicles (i.e., vehicles duly authorized by manufacturers in a third country and imported into China without the permission or license of the manufacturers) without justifiable cause; and
- The automobile manufacturer restricts its distributors from selling competing products of other automobile manufacturers. However, an automobile manufacturer may request that distributors provide a separate display area for the manufacturer's brand.

KEY LESSONS

- Although the Guidelines outline SAMR's enforcement position on key antitrust issues in the automobile industry, those views may be relevant to common issues in other industries as well.
- According to the Guidelines, an automobile manufacturer with low share in the market for cars may nevertheless be found to have dominant market positions in aftermarkets for parts and services for its own brand. This principle is relevant to other industries with a similar structure (i.e., original equipment and disposals/parts/services).

- SAMR presumes that fixed resale prices or restricted minimum resale prices are anticompetitive. Although there are limited "individual exemptions" (detailed above), SAMR may nonetheless decide the exemption is not applicable if the practice severely restricts competition.

- Recognized RPM exemptions include circumstances in which distributors have a limited intermediary role for invoicing, delivery, and payment collection, e.g. direct sales to big customers with distributor assisting on logistics; direct sales via e-commerce platforms and government procurement where it requires an auto manufacturer and its distributors to make a joint bid.

- Under the Guidelines, suggested resale prices or maximum resale prices may be an unlawful RPM violation if the majority of the distributors effectively enforce such prices as a result of pressure or incentives from the manufacturers.

- The Guidelines establish a safe harbor for vertical "non-price" territorial or customer restrictions if an automobile manufacturer's market share is less than 30%. The "presumptive exemption" applies unless the conduct severely restricts competition.

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ENDNOTES

1 *See* Liu Dahua v. Huayuan Industrial Co, Ltd. et al., (2012), (Min San Zhong Zi 22), *available in Chinese at* http://amr.shandong.gov.cn/art/2019/8/20/art__93584__7213277.html.

2 DOJ and FTC, Competition Issues in Aftermarkets Note from the United States, at 6, 10 (May 26, 2017), https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/aftermarkets.pdf.

3 *Id.* at 10.

4 *Id.*

5 The hardcore restrictions under the motor vehicle block exemption regulation are: (a) the restriction of the sales of spare parts for motor vehicles by members of a selective distribution system to independent repairers that use those parts for the repair and maintenance of a motor vehicle; (b) the restriction, agreed between a supplier of spare parts, repair tools or diagnostic or other equipment and a manufacturer of motor vehicles, of the supplier's ability to sell those goods to authorized or independent distributors or to authorized or independent repairers or end users; (c) the restriction, agreed between a manufacturer of motor vehicles which uses components for the initial assembly of motor vehicles and the supplier of such components, of the supplier's ability to place its trademark or logo effectively and in an easily visible manner on the components supplied or on spare parts.

6 Though safe harbors are recognized in many jurisdictions, there may be subtle differences in application. For example, in the EU, parties need prove market shares in both the upstream and downstream markets to meet the requirements of safe harbor. It is therefore insufficient to assess the automobile manufacturer's market share only, and the distributor's market share also must be checked.