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LESSONS FROM FOUR YEARS OF ANTITRUST ENFORCEMENT IN CHINA

China's Anti-Monopoly Law ("AML") celebrated its fourth anniversary in August 2012. Given the importance of the Chinese economy and the increase in antitrust enforcement in that country, the AML should rank high on in-house counsels' radar screens. In this *Commentary*, we analyze the main trends that we have observed in the last four years and try to predict how the future might look with regard to antitrust enforcement in China.

At the outset, it is important to note that while the AML borrows from foreign antitrust laws, in particular from Europe, it also contains some key China-specific features, notably specific requirements that enforcement agencies take into account industrial policy considerations. In addition, China's economic, legal, and cultural environment significantly differs from other jurisdictions. As a result, AML enforcement may not always lead to the outcomes that might be expected on the basis of mainstream antitrust principles as applied in other jurisdictions. Rather, market players should assess the compatibility of their conduct with the AML, bearing in mind these Chinese characteristics of the AML and the surrounding legal environment.

Another important caveat is that antitrust enforcement in China is still in its formative years. The three Chinese antitrust regulators, i.e., the Ministry of Commerce ("MOFCOM," responsible for merger control), the State Administration for Industry and Commerce ("SAIC," responsible for nonmerger enforcement, in particular non-price-related conduct), and the National Development and Reform Commission ("NDRC," responsible for price-related nonmerger conduct) are still in the process of building their capabilities. On the other hand, comparison with the early days of antitrust enforcement in Europe and the United States shows that China hardly is behind and indeed has made considerable progress in only a few short years.

The AML has already become one of the principal regulatory obstacles for many transactions, including global deals. As enforcement of the AML's nonmerger provisions becomes more vigorous, including through increased and much-anticipated private litigation, China is likely to become one of the "major" antitrust jurisdictions alongside the U.S. and Europe.

MERGER CONTROL

Merger control still represents the lion's share of antitrust enforcement in China. Since the AML came into force, MOFCOM has reviewed more than 500 cases. It has prohibited only one transaction, Coca-Cola's intended acquisition of Huayuan (*see* www.jonesday.com/antitrust-alert--coca-cola--huiyuan-deal-is-first-acquisition-blocked-by-china-antitrust-review-03-19-2009/), while approving 15 others with conditions. Below is a description of the most important merger control issues in-house counsel should be aware of:

Low Thresholds. The AML has introduced a mandatory pre-merger approval process that essentially catches any transactions involving parties with business in China of a certain size. These thresholds are relatively low, with the key thresholds requiring only approximately USD 63 million of revenues in China for each of at least two parties to the transaction. Hence, any merger or other transaction around the world involving two companies (including offshore ones) with fairly minimal sales in China is reportable under the AML.

There is no exemption for transactions having little or no nexus with China. Among other things, this raises issues for joint ventures entered into between large multinational companies, which are likely to be reportable in China (due to the China turnover of the parent companies), even if the joint ventures do not intend to operate in China. It will be up to the parties to decide whether they are ready to take the risk of not filing in China. However, when making such risk assessments, companies should note that MOFCOM's new filing form (effective from July 2012) now requires parties to provide lists of all transactions in the past three years in the same relevant markets involving the parties or their affiliates. Such a requirement could result in parties being required to disclose to MOFCOM the existence of transactions that were not filed.

It is unclear what sanctions MOFCOM will apply to concentrations that meet the reporting thresholds but are not filed in China, especially where there is little evidence of any anticompetitive effect on China. In theory, MOFCOM has the power to impose a relatively small fine on non-filing parties, as well as to order the parties to undo the transaction. Perhaps most importantly, in most cases it will be up to MOFCOM to determine whether the filing thresholds were met and whether it has the jurisdiction to review the transaction or impose sanctions on the non-filing parties. On the other hand, there is anecdotal evidence that MOFCOM has accepted parties' requests to waive certain more burdensome filing information requirements in some cases with no apparent impact on China.

Finally, MOFCOM also has the power to review any sub-thresholds transactions—before or after closing—that it believes may have anticompetitive effects in China.

Long Approval Process. The formal merger review procedure can include up to three phases of 30 (Phase 1), 90 (Phase 2), and 60 days (sometimes referred to as Phase 3) respectively. The formal procedure typically is preceded by a pre-filing intake process, during which MOFCOM will review an initial notification and propound one (or more) rounds of questions. The parties must respond satisfactorily in writing to those questions before MOFCOM will accept the filing as complete, thus starting the formal Phase 1 procedure and all associated timelines.

The timeframe for MOFCOM approval has become increasingly long. The majority of cases are approved only during phase 2. This is due to a series of factors, including an increasing workload for understaffed MOFCOM officials, but also the need in most cases for MOFCOM to gather views from other stakeholders, including other government ministries, trade associations, competitors, suppliers, and customers. Although there is anecdotal evidence of some phase 1 clearances in straightforward cases, even most transactions not raising antitrust issues will require at least three to four months from an initial filing attempt. A transaction that raises serious competition issues will require at least four months and frequently even five to seven months (i.e., until the end of Phase 2 or even the extended "Phase 3").

MOFCOM is working on a draft "simplified procedure" that would classify transactions, based on parties' market shares, the level of concentration in relevant markets, and other factors, into "simple," "normal," and "major" cases. To date, it appears that "simple" cases are envisioned to be cleared within the first 30 days of Phase 1 review (plus the time required for pre-filing acceptance). Decisions for "normal" and "major" cases are expected to fall within Phases 2 and 3 (within roughly 75 and 180 days after acceptance) respectively. But it remains unclear when such a simplified procedure will come into force and whether in practice it will result in expedited review and clearance of transactions without substantive concerns.

Importance of the Impact on the Chinese Market. One of the most important points to note about Chinese antitrust law is that the AML requires enforcement agencies—including MOFCOM in the context of merger review—to consider elements that are beyond classic antitrust analysis. In addition to assessing the impact of a proposed concentration on consumers, MOFCOM also must assess the anticipated effects on "national economic development," "the progress of technology," and "other undertakings" (i.e., other companies including competitors and customers). If there are potential anticompetitive effects, MOFCOM also must weigh whether "the concentration is in the public interest."

As a result, in all transactions, even those involving relevant geographic markets wider than China, MOFCOM invariably will require parties to provide China-specific data—not always easy to gather—and assess the effect on the Chinese market, including on Chinese customers and competitors. In transactions that involve products that are viewed as important to the Chinese economy, MOFCOM will not hesitate to impose commitments on merging parties to ensure that, for example, supplies to Chinese customers will continue as before, even if there is no evidence that the suppliers have incentives to stop supplying.

MOFCOM's broad mandate likely explains a series of decisions in which MOFCOM imposed somewhat unusual conduct remedies, including:

- **Russian Potash.** MOFCOM imposed on two merging Russian potash suppliers a requirement to continue to supply potash, which is essential for Chinese agricultural development, to Chinese customers (*see* www.jonesday.com/antitrust-alert--china-approves-merger-between-russian-potash-producers-but-requires-they-continue-to-supply-the-chinese-market-06-13-2011/);
- **Google/MMI.** MOFCOM imposed on Google the obligation to treat all handset manufacturers (which include several Chinese companies) in a nondiscriminatory manner in relation to the Android operating system (*see* www.jonesday.com/antitrust-alert--china-conditionally-approves-googles-acquisition-of-motorola-mobility-05-23-2012/);
- **Hard Disk Drives.** In *Western Digital/Hitachi* and *Samsung/Seagate*, MOFCOM imposed "wait-and-see" remedies reaching well beyond those required by other authorities around the world, essentially requiring the parties to both transactions to maintain themselves as separate, independent competitors for fixed periods of time. It is speculated that this was done to ensure that Chinese purchasers of hard drives (including computer manufacturers) would continue to have access to these products (*see* www.jonesday.com/antitrust-alert-lessons-from-chinas-merger-review-decisions-learned-in-recent-hard-drive-acquisitions-03-09-2012/).

More Conservative Approach. MOFCOM cannot yet rely on a wide body of prior decisions from which to draw some experience. As a result, MOFCOM tends to be more cautious when assessing claims made by the parties. This appeared clearly in *Google/MMI*, in which MOFCOM appeared not to take at face value both Google's assertion that it would not have incentive to stop licensing the Android operating system to other handset manufacturers, and Google's public pledge to continue licensing Motorola's patent under FRAND terms. Instead, MOFCOM required specific binding commitments directed to both of these points.

Similarly, MOFCOM's cautious approach appears to have informed its imposition of "wait and see" remedies in both *Western Digital/Hitachi* and *Samsung/Seagate*. Finally, MOFCOM's decision to require a private equity fund to divest its 28 percent minority stake in a business competing with the acquired business can also be explained by this significant level of caution (*see* www.jonesday.com/antitrust-alert--china-publishes-two-new-merger-decisions-under-anti-monopoly-law-11-22-2011/).

Gray Areas. The AML's provisions still contain many gray areas, making risk assessment even more important than in other jurisdictions. For example, the AML's merger provisions apply to "concentrations," which besides mergers also include the acquisition of control through equity, assets, or the capacity to exercise decisive influence on another undertaking by contract or by other means. There is no existing MOFCOM definition or guidance in this respect, so it is unclear whether the notion of "acquisition of control" used by MOFCOM will be similar to that used in the European Union, for example. The lack of clear definition would appear to give MOFCOM sufficient flexibility to review transactions that it believes should be reviewed, even if it also always retains the ability to review below-thresholds transactions.

Conclusion. We can hope that increased resources and experience will enable MOFCOM to speed up its review of most straightforward cases, including by becoming more comfortable with its own initial assessments of the competitive situation and of parties' assertions in such cases. Increased transparency on many issues is also to be expected in the future and is likely to make the process more predictable for all involved. However, because MOFCOM must continue to respect its broad mandate under the AML, it is to be expected that non-antitrust issues will continue to color its analysis in many higher-profile transactions.

NONMERGER ENFORCEMENT

The nonmerger provisions of the AML are enforced by two powerful ministries, NDRC and SAIC, which like MOFCOM also have substantial responsibilities beyond antitrust/competition. Like in Europe (but unlike in the U.S.), these authorities both investigate and adjudicate cases in the first instance. In addition, courts have jurisdiction over private antitrust lawsuits, as well as (at least in theory) review jurisdiction over agency decisions.

Administrative Enforcement. SAIC and NDRC appear to have been less active than MOFCOM to date. This may be somewhat illusory, as neither nonmerger agency is required to publish its enforcement decisions (although NDRC often has publicized cartel enforcement activities), while MOFCOM must publish its prohibition and conditional remedy decisions. In addition, SAIC and NDRC have the ability to terminate investigations without imposing fines if the violating party commits to change its behavior—something that could be particularly useful in the early stages of Chinese antitrust enforcement, where the regulators' primary goal may be to educate rather than sanction.

While MOFCOM already had built up some antitrust enforcement resources when administering the old merger review procedures contained in the Foreign M&A rules and in place prior to the AML, SAIC and NDRC have had to build up their AML enforcement resources from scratch (even if they had some prior experience with antitrust concepts under the Unfair Competition Law and the Price Law).

According to NDRC and SAIC, cartels have been the principal enforcement target in the past few years. Some of the key cases that have come to light include:

- In March 2010, NDRC issued its first reported fines and cease and desist orders under the AML on more than 30 rice noodle producers in Guangxi Province for price fixing.
- In January 2011, NDRC imposed a fine of RMB 500,000 (USD 80,000) on a trade association in Zhejiang Province for facilitating cartel agreements among its members. This appears to be the first antitrust fine by NDRC on trade associations.
- Later in 2011, two Shandong drug companies received the largest to date fine of more than RMB 7 million (USD 1.1 million) from NDRC for their anticompetitive conduct.
- In May 2011, NDRC issued a fine of RMB 2 million (USD 300,000) to Unilever for publicly announcing a potential price increase of around 10 percent for some of its household products. Such announcement led to consumer "panic" buying in a number of cities. NDRC found Unilever's behavior in violation of the Price Law as "spreading price increase information" that disrupted market order. This is believed to be the first antitrust-related fine against a foreign multinational company.

- In the first half of 2011, NDRC launched an antitrust investigation into China Telecom and China Unicom, the two largest state-owned telecommunication companies, which were alleged to have abused their dominance through price discrimination. Although the potential fine could be up to several billion RMB, both companies pledged to undertake corrective measures in exchange for suspension of the investigation. The case is reportedly still pending as the authorities review the companies' performance of their commitments.
- In early 2011, SAIC imposed its reportedly first antitrust fine on a concrete trade association in Jiangsu Province and five of its members for market allocation.
- In August 2012, SAIC also fined 11 secondhand car traders for market allocation and price fixing.

Antitrust Litigation. In contrast to intellectual property disputes, for which China ranks as the most active country worldwide, antitrust litigation has been relatively muted in the first four years of the AML. According to the PRC Supreme People's Court ("SPC"), only 61 AML cases were filed—which in China may mean were accepted by the courts—through May 2012.

Antitrust litigation in China is likely to gather speed after the adoption in May 2012 of the SPC's Rules on Civil Litigation under the AML (*see* http://www.jonesday.com/antitrust-alert--chinese-supreme-peoples-court-sets-framework-for-antitrust-litigation-05-08-2012/). These Rules set out a comprehensive framework for antitrust litigation, including issues relating to court jurisdiction, burden of proof, the use of expert witnesses, damages, and the statute of limitations.

Among the main cases filed over the last several years were:

- ***China Mobile.*** Shortly after the effective date of the AML, in 2009 a China Mobile customer filed an action alleging that the state-owned telecoms firm had abused its dominant position in the China cellular telephone service market by charging customers monthly service fees in addition to usage fees and by charging subscribers different fees for substantially similar services. Several months later, the parties settled and the customer withdrew the lawsuit.
- ***Sursen vs. Shanda and TRISC vs. Baidu.*** These two cases in 2009 both involved allegations of abuse of dominant market position under the AML (*see* www.jonesday.com/antitrust-alert--new-chinese-court-developments-provide-insights-into-anti-monopoly-law-11-04-2009/ *and* www.jonesday.com/antitrust-alert--second-chinese-dominance-decision-issued-under-the-china-anti-monopoly-law-01-04-2010/). The courts in both cases ruled that defendants had failed to prove the existence of dominant market position.
- ***Johnson & Johnson.*** In February 2012, Johnson & Johnson ("J&J") was sued by a distributor alleging that J&J had violated the AML by setting minimum resale prices (resale price maintenance, or "RPM") for medical equipment and wrongfully terminated its distributor agreement after the plaintiff sold equipment below that minimum resale price. In May 2012, the court ruled in favor of J&J on the basis that the plaintiff had failed to prove anticompetitive effects from the RPM restraint. This decision would appear to confirm that RPM is subject to something akin to a "rule of reason" analysis under Chapter II of the AML (including the possibility of exemption under certain circumstances per Article 15) and will not be treated as a *per se* prohibition. From the published judgment, it seems that the plaintiff failed to provide any evidence of anticompetitive effects from the RPM clause other than a short product description from J&J's web site, which was found to be insufficient. Given that the plaintiff did not submit any evidence, the court apparently did not proceed to review the various factors (presumably at least including J&J's market share) to assess whether the RPM clause in this particular case was anticompetitive. The case reportedly is now on appeal.
- ***Qihoo vs. Tencent.*** Earlier this year, Qihoo 360 Technology Co., Ltd. ("Qihoo"), a large computer safeguard software company, filed a lawsuit against Tencent, a leading instant message software and internet social platform provider. Qihoo alleged abusive conducts by Tencent, including forcing its user to uninstall Qihoo's software, claiming damages of RMB 150 million. The court heard the case in April, where both the parties presented expert testimony by economists. The case is still pending.

CONCLUSION

It has taken only a few years for China to become one of the main merger control jurisdictions. Given the willingness of SAIC and NDRC to step up their enforcement activities, it is likely that China will also become an important jurisdiction on the nonmerger side. This will more particularly be the case if the newly adopted rules on private litigation lead to an increase in private enforcement.

Companies with significant business activities in China should take into account the specific features of the AML and of the Chinese legal environment when assessing antitrust compliance in China. Given the broad scope of the AML, and the unique characteristics of the Chinese legal environment, compliance policies as well as expectations in China may have to diverge from those in other major jurisdictions.

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