
China Merger Regulations and Anti-Monopoly Law Now in Place

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On August 3, 2008, the Anti-Monopoly Enforcement Authority (AEA) issued merger regulations in connection with China's Anti-Monopoly Law (AML), which took effect August 1, 2008. The AML represents China's full entry into the world of global competition law and its emerging role as a major player among competition authorities. The AML brings about a profound change for businesses with (or contemplating) operations or investments in China.

In particular, under the new law

- As in most industrialized countries, "hard core" anticompetitive agreements among competitors are considered *per se* illegal and offenders are subject to significant penalties.
- With respect to vertical agreements, the AML now subjects a wide range of relatively commonplace distribution arrangements to potential scrutiny and prohibits exclusive territorial arrangements and pricing arrangements (an approach that diverges significantly from the treatment of such arrangements under U.S. antitrust laws).
- Leading firms will be subjected to heightened scrutiny under the AML's provisions regarding abuse of a dominant market position (and significantly, a dominant market position is presumed with a 50 percent market share), with prohibitions that include "unfairly high or unfairly low" pricing and imposing an affirmative duty to deal absent objective business justifications.
- Companies contemplating mergers and acquisitions (M&A) activity that may have an appreciable effect on a Chinese market will be subject to merger notification thresholds even if the parties do not have operations in China.

This article (1) summarizes the AML and the merger regulations, (2) contrasts the AML to U.S. and EU competition law, and (3) provides practical guidance for companies doing or intending to do business in China.

Overview of the AML

The AML prohibits monopolistic conduct that occurs in China or foreign conduct that affects competition within China. Article 3 of the AML defines three categories of "monopolistic conduct": (1) monopoly agreements, (2) abuse of dominant market position and (3) mergers or acquisitions that would result in lessened competition.

MONOPOLY AGREEMENTS

The AML provides that two types of monopoly agreements may be deemed illegal and invalid upon investigation and recognition by the AEA: (1) a monopoly agreement between the competing business carriers (*i.e.*, horizontal agreements), and (2) a monopoly agreement between the business carriers and their suppliers or customers (*i.e.*, vertical agreements).

The AML prohibits agreements that are presumed to have a detrimental effect, such as agreements to fix prices or output, to allocate markets, to hamper innovation or to engage in group boycotts, regardless of whether these agreements arise in a horizontal or vertical context. To a large extent, the AML's treatment of specified horizontal agreements parallel agreements that are considered *per se* unlawful under the Sherman Act and similarly considered "hardcore" under EU competition rules. Under U.S. and EU rules, agreements to fix prices or restrict output, group boycotts and market allocation agreements are considered *per se* (or effectively *per se* in the European Union) unlawful among horizontal competitors. However, with respect to vertical agreements (that is, agreements between companies at different levels of distribution), U.S. antitrust law differs significantly from the AML, as U.S. courts almost always analyze vertical agreements under the more lenient rule of reason test. Likewise, with the exception of air-tight territorial restrictions between Member States, the EU rules pertaining to vertical restraints are markedly less restrictive than the approach seemingly adopted under the AML.

Monopoly agreements may be permitted in certain circumstances, as outlined in Article 15 of the AML, where the transaction is likely to benefit, not reduce, competition, such as an agreement to improve technology or develop new products, or an agreement to improve product quality or reduce costs. While these considerations are similar to rule of reason considerations in the United States and the exemption criteria under Article 81(3) of the EC Treaty, important differences remain. In particular, agreements whereby a supplier allocates its distribution territories using exclusive distribution arrangements would not be tolerated under the

AML, whereas these types of agreements have been routinely upheld in the United States and (at least with respect to territorial restrictions on active sales) in the European Union as well.

ABUSE OF DOMINANT MARKET POSITION

The AML prohibits any company with a dominant market position from abusing that position to eliminate or restrict competition in China. Conduct considered an abuse of a dominant market position, as outlined in Article 17 of the AML, include the following:

- i) Selling products at unfairly high prices or buying products at unfairly low prices (note that no justification is permitted for such practices)
- ii) Selling products at prices below cost without any justifiable cause
- iii) Refusing to trade with a trading party without any justifiable cause
- iv) Restricting a trading party so that it may only exclusively conduct business with the dominant company or with the business carriers they designate without any justifiable cause
- v) Implementing tie-in sales or imposing other unreasonable trading conditions at the time of trading without any justifiable cause
- vi) Applying discriminatory treatments on prices or other trading conditions to trading parties with equal standing without any justifiable cause
- vii) Other acts of abusing the dominant market position as determined by the AEA under the State Council

This catalogue approach is similar to that of Article 82 of the EC Treaty (Article 82 EC), which provides illustrative examples of abusive conduct by dominant firms, many of which (*e.g.*, below-cost pricing and monopsonistic conduct) have likewise been prohibited under Section 2 of the Sherman Act in the United States. Unlike the U.S. rules, however, the AML also calls out “excessive pricing” as a category of abusive conduct, as does Article 82 EC. Further, like the European Union, China treats price discrimination as a category of abuse of a dominant market position, unlike the United States, which may prohibit price discrimination under the Robinson-Patman Act even if the discriminatory firm does not possess a dominant market position. Perhaps most striking, however, is the AML’s affirmative duty to deal. This provision breaks new ground even as compared to the express language of Article 82 EC, but is perhaps directionally consistent with the European Union’s more expansive views on a dominant firm’s duty to deal (as compared to the U.S. approach, which has recognized such a duty under only very narrow circumstances).

Article 18 of the AML identifies several factors that the AEA will consider in determining whether a company dominates the market and, therefore, is prohibited from engaging in the practices outlined above. These factors include (1) “market share” and “competitive status in the relevant market;” (2) control over market inputs, such as raw materials; (3) “financial and technical status;” and (4) ease of entry. Under the AML, companies are presumed to dominate a market if the company’s market share exceeds specified thresholds. Notably, the 50 percent market share threshold in China is substantially lower than the 70 percent benchmark under U.S. law, although similar to EU rules where a dominant position is presumed where a company’s market share exceeds 50 percent. Two- and three-firm concentrations are presumed to dominate a market under the AML if they hold a combined 66.7 percent and 75 percent market share, respectively. There is no U.S. corollary under Section 2 of the Sherman Act to these two- and three-firm concentration ratios under the AML, although oligopoly-based standards have been employed in other jurisdictions (*e.g.*, Germany).

ESTABLISHMENT OF ANTI-MONOPOLY AUTHORITIES

At this time, only the merger regulations have been issued, and the agency designated to review concentrations has not yet been established. It is expected that the current merger review procedures will change with the anticipated establishment of a new agency to review mergers and with the issuance of enforcement guidelines. Before the AML became effective, Chinese merger review was governed by the Regulations on the Mergers & Acquisitions of Domestic Enterprises by Foreign Investors (M&A Regulations). The M&A Regulations required notification of certain transactions to both the Ministry of Commerce (MOFCOM)

and the State Administration of Industry and Commerce (SAIC). In the absence of any newly established agencies, MOFCOM will continue to review transactions under the merger regulations (discussed below).

Through communication with MOFCOM, we learned that it is preparing to establish an “Anti-Monopoly Investigation Bureau” (the Bureau). The establishment of the Bureau will end the “double examination” system, in place for approximately five years, whereby mergers were notified to both MOFCOM and SAIC. This development will improve the efficiency of examination and align China’s enforcement efforts with the practices of other competition authorities. The Bureau will enforce the merger regulations (discussed below) and review concentrations concerning foreign funded enterprises and Chinese domestic enterprises. At this time, the final name of the Bureau and its specific organization and composition of members have not yet been determined.

We understand that China’s National Development and Reform Commission will establish a new agency responsible for examining unlawful monopoly agreements, and SAIC will establish a new agency responsible for reviewing potentially unlawful abuses of dominant market position.

Merger Regulations

The AML prohibits concentrations where the effect of those transactions is to restrict competition in China. In other words, China’s AML extends to transactions that do not occur within China, as long as they have a restrictive effect on competition in China. This prohibition may have wide-reaching effects on companies merging throughout the world, depending on how the Chinese antitrust enforcement agencies choose to interpret a merger’s impact on competition in China.

Companies must notify the anti-monopoly enforcement authority identified by State Council of China of all transactions that meet one of the following thresholds:

- i) **Total global turnover** for the previous fiscal year of all business operators participating in the concentration in excess of RMB 10 billion (approximately \$1.5 billion), and at least two of these business operators each had a turnover of more than RMB 400 million (approximately \$60 million) within China during the prior fiscal year.
- ii) The **total turnover within China** in the previous fiscal year of all the business operators participating in the concentration in excess of RMB 2 billion (approximately \$300 million), and at least two of these business operators each had a turnover of more than RMB 400 million (approximately \$60 million) within China during the prior fiscal year.

These notification thresholds represent a critically important change from the prior internal draft of the notification thresholds in that they eliminate the market share threshold of 25 percent. The elimination of this criterion represents an extremely important change since it ensures that the notification thresholds are objective and do not introduce the subjective notion of market share in a “relevant market” for purposes of determining whether merging companies are required to submit a pre-merger notification filing with the Chinese authorities.

Penalties

Companies that engage in monopolistic conduct prohibited by the AML may be subject to civil penalties under Article 46. These penalties include the following:

- Payment of 1 percent to 10 percent of the total sales volume in the relevant market from the previous year
- An order requiring the company (or companies) to cease and desist the prohibited conduct
- Confiscation of “the illegal gains”

Companies engaged in monopoly agreements may mitigate their fines by “report[ing] their monopolistic conduct to the AEA and provid[ing] important evidence.” This approach is similar to the U.S. Department of Justice’s Amnesty Program, the European Commission’s Leniency Policy and similar programs in place in many countries.

Under the AML, private companies or individuals may also seek compensatory damages through China's judiciary system, though it is unclear how private litigations will be conducted. This is a notable development as it represents a convergence with remedies available in the United States as well as the European Commission's recent recommendations to make compensatory damages more readily available within the European Union.

Practical Guidance for Companies with (or Contemplating) Operations in China

In light of the new law, companies doing business or contemplating doing business in China should consider the following:

- Review and update **internal antitrust compliance programs** to ensure business practices do not infringe on AML or merger regulations.
- Consider **training sessions** to educate business personnel of China's new antitrust enforcement regime.
- Conduct a "**dominance audit**"—review current operations under the AML to determine whether the company is likely to be regarded as "dominant" in any market in China.
- Review **internal documents** prepared in the ordinary course of a company's Chinese business, such as business plans, strategy plans or marketing plans, to ensure business plans do not include any conduct that may be an abuse of dominant market position under AML.
- Review **pricing policies** vis-à-vis Chinese market position to ensure policies do not suggest an abuse of a dominant market position.
- Review "**monopoly agreements**" to determine whether they may be justified as pro-competitive pursuant to Article 15 of the AML.
- Consider **offensive uses** for prohibitions of anticompetitive conduct against competitors or suppliers that may hold a dominant market position—*e.g.*, leverage prohibition against refusals to deal to prevent suppliers from refusing to deal.
- Review **distribution policies** with regards to Chinese business.
- Carefully review participation in **trade associations** in China—previously, involvement with such groups was lawful and encouraged; however, such conduct may now give rise to antitrust issues in China.
- **Audit commercial conduct** to detect potential problems before the regulators become aware of them and leniency is no longer available.

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For more information, please contact your regular McDermott or MWE China lawyer, or:

Lawrence I. Fox: lfox@mwe.com +1 212 547 5403

John Z. L. Huang: johnhuang@mwechinalaw.com +86 21 6105 0588

Raymond A. Jacobsen: rayjacobsen@mwe.com +1 202 756 8028

Scott S. Megregian: smegregian@mwe.com +44 20 7577 6911

Kevin Y. Qian: kqian@mwechinalaw.com +86 21 6105 0566

Clive Stanbrook, QC: cstanbrook@europe.mwe.com +32 2 282 35 44

Joseph F. Winterscheid: jwinterscheid@mwe.com +1 202 756 8061

Andrea L. Hamilton: ahamilton@europe.mwe.com +32 2 282 35 15

Carla A. R. Hine: chine@mwe.com +1 202 756 8095

For more information about McDermott Will & Emery, visit www.mwe.com.

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