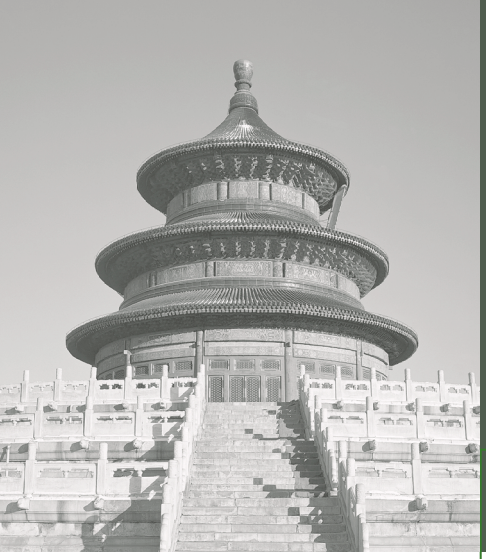

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CHINA PRACTICE UPDATE

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China's Proposed Anti-Monopoly Law: Highlights for Foreign Business

Introduction

Well-designed competition policy can promote consumer welfare and economic growth. Poorly designed policy can retard both. As China's importance in the world economy grows steadily each year, so does the importance of its competition policy. Because China is a low-cost manufacturing center and home to an enormous market, foreign companies have invested in China extensively, including through joint ventures with Chinese companies that involve sharing the foreign companies' intellectual property rights with their Chinese partners.

China has been working on anti-monopoly legislation for about ten years. Under the Provisional Rules, foreign merger notification has technically been in force since 2003, and increasingly foreign corporations are complying with these requirements.[1] Since China's 2001 entry into the World Trade Organization, these efforts have been gaining momentum. It is now expected that the legislation will be enacted by the end of next year.[2]

The Chinese government released the latest draft of the proposed Anti-Monopoly Law (Draft) in early April and hosted an International Seminar on the Draft at the end of May. Shortly before the Seminar, the American Bar Association (ABA) Sections on Antitrust Law, Intellectual Property Law and International Law jointly submitted comments on the Draft. The April Draft, as the Sections note, represents a marked improvement over the previous 2002 draft, but continues to include some provisions that should be of concern to US and European companies doing business in China, particularly as it involves the licensing of IP rights.

Article 56 provides that the Anti-Monopoly Law will not apply generally to the exercise of IP rights, unless they qualify as an "abuse" of those rights that violates the law. The Draft, however, does not define what conduct constitutes an "abuse" so that any violation of the law could, in theory at least, be found to be an "abuse." This is of particularly great concern given the widespread piracy of intellectual property

1. The Provisional Rules on Mergers with and Acquisitions of Domestic Enterprises by Foreign Investors (the Provisional Rules), issued by the Ministry of Commerce (MOFCOM) and State Administration for Industry and Commerce (SAIC), took effect on April 12, 2003.

2. Passing anti-monopoly laws is on the current legislative plan of the 10th National People's Congress, whose five-year term ends in March 2008. See Wang Xiaoye, Recent Developments in Chinese Antitrust Law, Address Before the American Bar Association (Oct. 5, 2004) (transcript available at http://www.abanet.org/antitrust/committees/international/international_word_docs/speech_to_aba_on_oct.5.doc).

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for which China is already infamous. (It has been estimated, for example, that 90% of DVDs sold in China are pirated.) It would be a serious mistake, for example, if the Anti-Monopoly Law were applied to require compulsory licensing of valuable IP rights at royalty levels that did not allow their owners to earn an adequate return on their investment in a misguided effort to assist domestic Chinese manufacturers, or to prohibit foreign licensors from retaining IP rights in derivative technologies created by Chinese licensees. Fortunately, the drafters have said that they are open to recommendations on how to define or narrow the meaning of "abuse" in Article 56.

In this bulletin, we describe the key provisions of the proposed Anti-Monopoly Law. In the course of so doing, we identify the principal outstanding issues so that our clients doing business with China will understand the risks they may face if the law is enacted in its current form.

The April Draft provides that the principal purpose of the law is to "prohibit monopolistic conduct," replacing the previous draft's purpose of "prohibiting monopoly."

Key Features of the Draft Law

Objectives

The April Draft provides that the principal purpose of the law is to "prohibit monopolistic conduct," replacing the previous draft's purpose of "prohibiting monopoly." This revision brings the law more in line with prevailing international norms, which recognize that monopolies that result from "superior skill, foresight and industry" should not be unlawful, and that antitrust laws should instead focus on preventing monopolies from being achieved or maintained by exclusionary or predatory conduct, rather than through competition on the merits.[3]

We remain concerned, however, that Article 1 continues to identify additional, more amorphous objectives such as "ensuring the healthy development of the socialist market economy." In the United States and Europe, competition law is now seen as serving a single over-riding purpose: to enhance consumer welfare by protecting competition.[4] As a top economist in the Department of Justice Antitrust Division says, "Efficiency is the goal; competition is the process."[5] In addition, the Draft continues to use unduly vague terms, such as "unfair prices," in some articles. The combination of multiple objectives and vague terminology leaves a great deal of discretion in the hands of the administrators of the law, thereby creating a real danger that the law may be misapplied to regulate competition, rather than to protect it.

Substantive Provisions

The substantive provisions of the proposed legislation are organized into eight chapters. Of greatest interest to foreign companies are the second, third and fourth chapters, regarding Monopoly Agreements, Abuses of Dominant Market Position and Control of Concentrations, respectively. These chapters define the offenses under the proposed law.

Chapter 2: Prohibiting Monopoly Agreements

Chapter 2 defines the types of agreements the law will prohibit as monopolistic. Article 8 provides that the law will treat as monopolistic agreements to (i) fix, maintain or change prices of products; (ii) limit the output or sale of products; (iii) allocate sales markets or raw materials purchasing markets; (iv) limit the purchase

3. See *United States v. Aluminum Company of American (ALCOA), 148 F.2d 416 (2d Cir. 1945).*

4. *Joint Submission of the American Bar Association's Sections of Antitrust Law, Intellectual Property Law and International Law on the Proposed Anti-Monopoly Law of the People's Republic of China 2 (May 19, 2005) [2005 Joint Submission]* (available at *http://www.abanet.org/antitrust/jt-pdf/joint-comments/abaprcat2005finalcombowapp.pdf).*

5. *William J. Kolasky, Deputy Assistant Attorney General, Antitrust Division, US Department of Justice, The Role of Competition in Promoting Dynamic Markets and Economic Growth, Address Before the TokyoAmerica Center (Nov. 12, 2002)* (transcript available at *http://www.usdoj.gov/atr/public/speeches/200484.htm).*

of new technology or new facilities, or the development of new products or new technology; (v) jointly boycott transactions; (vi) limit resale prices; or (vii) rig bids. Article 9, in turn, exempts from Article 8 agreements that improve product quality, reduce cost or increase efficiency, so long as they will not completely eliminate competition and so long as those benefits are likely to be passed on to consumers.

The new draft of Chapter 2 is a major improvement over earlier versions. The drafters appear to be following the lead of the European Union in moving away from an individual exemption system toward a US-style rule-of-reason approach. This approach should permit agreements that have the potential to create efficiencies and thereby enhance competition without the need for such agreements to be submitted to the competition authority for approval.

The new draft of Chapter 2, however, continues to fail to distinguish between vertical and horizontal agreements, whether with respect to products, prices or IP rights. This may not necessarily be a problem if the law is implemented in a manner that recognizes that vertical agreements should be treated more liberally than horizontal agreements, but it highlights the importance of getting implementation right.

Chapter 3: Prohibition of Abuse of Dominant Market Position

Chapter 3 defines and prohibits "abuse of a dominant market position." Unlike Chapter 2, this Chapter continues to suffer from serious, fundamental defects, thereby creating a risk that the law will be used to regulate business conduct in a manner that would be antithetical to sound competition principles. There are four main areas of concern: the recognition of shared monopolies, the strong presumption of market power from market share, the prohibition on excessive pricing, and the inclusion of an overbroad essential facilities doctrine.

First, Article 13 defines "dominant market position" as "the market power of one or several undertaking(s) to determine, maintain, or alter the price, quantity, or other trading conditions of relevant products so as to eliminate or restrict competition within the relevant market." This definition makes it possible for two or more entities to be found jointly to have a "shared monopoly," even if they do not coordinate their conduct. This would be contrary to the competition laws of both the United States and the European Union, which do not recognize any similar concept of "shared monopoly" without further evidence of concerted conduct with anti-competitive effects.

Second, Article 15 establishes a presumption of dominance based on market share thresholds as low as 50% for a single firm. This risks extending the law so that it can be used to regulate the normal competitive conduct of firms that have little, if any, real market power. Article 15 also creates a presumption of joint dominance where two undertakings jointly occupy 2/3 of the market, or three undertakings jointly occupy 3/4 of the market. These thresholds ignore the economic reality that many sectors can be fiercely competitive with only two or three strong firms.

Third, contrary to law and practice in the United States and the European Union, Article 16 prohibits undertakings with dominant market positions from selling or buying products at prices that are "unfair," i.e., too high or too low. This prohibition could be read to empower the administrator of the law to act effectively as a price regulator, "a role that is antithetical to an efficiently functioning market system, and likely to harm competition and, ultimately, consumers."[6] We recognize that China has a history of imposing fixed or, more recently, guidance prices on commodities. We believe that China should continue to move away from price regulation, rather than create

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6. *2005 Joint Submission,* supra *note 3, at 17.*

a fresh basis for price regulation under the rubric of anti-monopoly regulation.

Fourth, and finally, Article 22 of the new draft embraces the essential facilities doctrine, and would prohibit an undertaking in a dominant market position from "refusing to deal with other undertakings that seek access to its infrastructure or other essential facilities with reasonable price offers," if the other undertakings are unable to compete with the dominant undertaking without such access. This provision raises particular concern with respect to IP rights. The essential facilities doctrine has been held not to apply to IP rights in the United States,[7] and can be applied to IP rights in the European Union only in "exceptional circumstances."[8] Using competition laws to compel access to valuable IP risks undermining the incentives to invest and innovate and would, therefore, be antithetical to the fundamental objectives of those laws. At the May Seminar on the Draft held in Beijing, the drafters argued that the law was aimed at "physical networks," specifically telecom networks, and not IP rights, but the language of the draft law provides no such limitation, again emphasizing the importance of proper implementation.

Chapter 4: Control of Concentrations

China in 2003 imposed notification obligations on foreign-related, but not purely domestic, merger and acquisition transactions. Under the 2003 Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, notification to the Ministry of Commerce and State Administration for Industry and Commerce is required for onshore transactions based on the amount of operating revenues in China, the number of investments in China in the relevant industry, and market share. Notification for offshore transactions may also be required if the acquiring company's assets or turnover in China exceed certain thresholds. The initial review period is 30 days, after which no response is deemed an approval. As of this writing, our understanding is that no notified transaction has been rejected or altered by the Chinese authorities.

Chapter 4 of the AML will establish new procedures for merger clearance for all transactions, both domestic and foreign. This Chapter is a substantial improvement from earlier drafts in which the standards and procedures for merger review were extremely opaque. There are still concerns, however. The thresholds for notification and calculation of turnover in Article 24 still do not require a sufficient nexus to domestic commerce and appear inconsistent with the International Competition Network's (ICN) recommended practices, which seek to establish an international norm for the review of multinational mergers. The Draft also relies on subjective market share thresholds for merger notification, which the ICN advises against because they are difficult to apply in practice.

The Draft provides for an initial review period of 45 days instead of the 30 days provided under the current law. Most merger control regimes now have a 30-day initial review period. While an additional 15 days may not pose serious problems in most transactions, it would be desirable for China to conform its review period to the emerging international norm.

Administration and Enforcement

Chapter 6 outlines how the Anti-Monopoly Authority will be administered. Article 36 of the Draft provides for the establishment of a single Anti-Monopoly Authority (Authority) that (1) formulates anti-monopoly policies and rules; (2)

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7. See *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko LLP, 504 U.S. 398 (2004).*

8. See *Case C-418/01,* IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG, 2004 *ECJ* CELEX LEXIS *166 (Apr. 29, 2004).*

investigates anti-monopoly matters; (3) handles cases in violation of the law; (4) investigates and evaluates market competition conditions; (5) conducts international exchanges and cooperation with foreign jurisdictions and negotiations of multilateral and bilateral agreements on competition; and (6) handles other anti-monopoly matters in connection with the law. Article 38 grants the Authority further powers of inspection to search residences and business locations, to access and retain relevant evidence, and to inquire about bank account information. This unified structure seems more likely to result in greater efficiency and consistency than the division of regulatory authority among several government agencies, as provided in some earlier versions of the law. But the broad discretionary powers granted to the Authority also highlight that the Authority's staff will have great influence over how the law is enforced. It is important, for example, that the Authority's staff include professionally-trained economists who understand how markets work.

The Draft provides some checks on the Authority's power. The Authority's investigators must keep a written record of their investigation (Article 40), keep trade secrets confidential (Article 41), and publish the Authority's decisions on the day of issuance (Article 43). The Draft also provides undertakings investigated by the Authority with certain rights, including the right to submit statements and defenses to the Authority (Article 42) and the right to administrative judicial review in an intermediate people's court. The existence of these provisions is a positive sign, though they would be more reassuring if they also required, for example, that the Authority's decisions lay bare the Authority's reasoning.

Chapter 7 describes the penalties for violations of the Anti-Monopoly Law. Prohibited abuses of dominant market position face a required cease and desist order, and may also face fines of between RMB 100,000 and RMB 10,000,000, not to exceed 10% of the turnover in the relevant market in the proceeding year (Article 47). Prohibited monopolistic agreements face the same penalties, plus a mandatory invalidation of the agreement (Article 46). Merging undertakings that either failed to notify the Authority when required, or failed to comply with the obligations the Authority set out in its decision to allow the merger, also face harsh mandatory penalties. The Authority will (1) declare the concentration concerned void, and (2) order the undertakings concerned (A) to dispose whole or part of its stock, (B) to transfer part of the business, (C) to dismiss the persons responsible from their positions and/or (D) to impose other necessary penalties. In addition, the Authority may also impose fines of between RMB 100,000 to RMB 10,000,000, not to exceed 10% of the turnover in the relevant market in the preceding year (Article 48). All three of these provisions also declare that any conduct in connection with the violation of the anti-monopoly law that "constitute criminal offences" shall be investigated for criminal liability (Article 49).

The Draft also authorizes the Authority to order investigated parties to comply with investigations and provide materials and information, and to impose fines up to RMB 1 million for failure to comply (Article 51). With such potentially harsh penalties available under the law, clarity of statutory language and transparency and consistency of enforcement will be vital.

Conclusion

While the Draft shows significant progress from the 2002 version, and demonstrates that the Chinese government has taken the comments it has received seriously, the law still needs further improvement in order to be brought into line with international standards before enactment. As we move forward, it is critical that we maintain an ongoing dialogue between China and international anti-monopoly experts to ensure that China remains a welcoming environment for foreign investment and a safe home for competition.

Pamela Bookman, a summer associate at the firm, contributed to the research and drafting of this bulletin.

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