China Enacts National Competition Law

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Culminating a 13-year drafting process, on August 30 the Standing Committee of the National People's Congress enacted China's first competition law, the Anti-Monopoly Law ([Fan Long Duan Fa]). This event constitutes a major milestone in China's development and attendant regulation of an increasingly market-driven economy, and is of major importance to both Chinese and foreign companies. In particular, the law applies to monopoly conduct in the People's Republic of China (PRC) and to monopoly conduct outside the PRC that has a restrictive effect on competition in the PRC (Article 2). Although the law does not address the status of Hong Kong, Macau and Taiwan, those areas may be considered as lying outside of the PRC for purposes of the law.

Monopoly Agreements. The law identifies a list of prohibited "monopoly agreements between competing undertakings" (Articles 13 and 14), including agreements to fix or change prices; limit production or sales volumes; divide sales or procurement markets; restrict the purchase of new technology or new facilities or the development of new technology or new products; engage in joint boycotts; set resale prices; or set minimum resale prices. All such agreements are presumptively illegal, although the businesses that are parties to the monopoly agreement may rebut that presumption by showing that the agreement will, in fact, not substantially restrict competition and consumers will share in the resulting benefits (Article 15). Moreover, agreements are permitted on a showing that they are intended to upgrade technology or R&D; improve product quality; raise efficiency; unify product specifications or standards; create a professional division of work; improve the efficiency or competitiveness of small and medium-sized enterprises; further social and public interests such as energy conservation, environmental protection and disaster relief; relieve an economic depression by moderating decreases in sales or production surpluses; or are for foreign trade and economic cooperation (Article 15). Importantly, the law also provides for discretionary amnesty or leniency for any party to a monopoly agreement that self-reports to the government: parties that report their misconduct and provide important evidence to the authority may receive complete relief from or mitigation of the normal penalties for entering into a monopoly agreement (Article 46).

Abuse of Dominant Position. The law prohibits companies in dominant market positions from selling at unfairly high or buying at unfairly low prices; selling below cost without justification; refusing to deal with trading parties without justification; exclusive dealing; tying; or applying

discriminatory terms to equally situated trading parties without justification (Article 17). The law specifies several factors--including market share, barriers to entry and financial and terminological conditions of the company--relevant to determining whether a company holds a dominant position (Article 18). A dominant position is presumed if a company has a one-half or greater market share; for each of two companies that together have a two-thirds or greater market share; and for each of three companies that together have a three-quarters or greater market share. There is an exception to the presumption for any company with less than a one-tenth market share (Article 19). The law does not provide a detailed definition of "relevant market," but specifies that a "relevant market" is "the territorial area or scope of commodities within which undertakings compete against each other during a period of time for particular commodities or services"(Article 12). Accordingly, the law seems to allow markets to be defined geographically in ways that are narrower or broader than all of China. This is in accord with the position taken by officials in the PRC's Ministry of Commerce prior to enactment of the law.

Concentrations or Mergers and Acquisitions. China currently has a review regime for mergers and acquisitions by foreign entities under regulations promulgated in 2003 and expanded in 2006. The regime has led to second-phase reviews in some cases, but has not resulted in sanctions for failure to notify. A failure to notify, however, could lead to problems in the investment approval process for elements of the transaction that take place in the PRC. The law mandates filings for mergers, acquisitions and other transactions that result in control by contract or other means without regard to the nationality of the acquirer, but does not specify reporting thresholds. The thresholds are to be set by the State Council (Article 21). This allows for the possibility of exemptions for transactions below a monetary threshold or with a *de minimis* impact on competition, but it remains to be seen whether the State Council will include such exemptions. The law requires an initial submission of information about a transaction (Article 23) followed by a 30-day first-phase review period (Article 25). Transactions that are determined to require further examination will be subject to a 90-day second-phase review period. In a change from the 2006 regulations, the review periods are measured in calendar days rather than business days. The parties may not complete their merger during the review period (Article 26). Although in contrast with existing regulations, the law will subject even domestic transactions to anti-monopoly review, and also provides for a separate national security review of mergers and acquisitions or other participations by foreign capital in domestic enterprises (Article 31). Similar review has been in place since the 2006 regulations, which refer to national economic security rather than the potentially narrower term "national security." It is unclear whether the new term signifies an intent to narrow the scope of the security review, which has been invoked in transactions involving products such as cookware and construction equipment.

Administrative Monopolies. One particularly welcome set of provisions in the law concerns administrative monopolies, such as monopolies created by administrative authorities or organizations. Such administrative monopolies are prohibited from requiring companies to purchase from or deal with favored businesses (Article 32), discriminating against non-local entities (Article 33-35) and engaging in other monopoly conduct (Article 36-37). State-owned enterprises may occupy controlling positions in industries relevant to the national economy and state security,

but may not take advantage of their positions to harm consumers (Article 7). Although these provisions will primarily benefit domestic companies, foreign businesses will also benefit.

Enforcement Authority

The law entrusts enforcement of its antitrust-focused provisions to a new agency, the anti-monopoly implementation or enforcement authority (Article 10). The authority will perform work (including merger reviews) currently handled by other agencies--the Ministry of Commerce (MOFCOM) and the State Administration for Industry and Commerce (SAIC)--under existing Chinese law. The authority is empowered to investigate suspected anti-competitive conduct through inspections, questioning of individuals and examination of business records--subject to the requirement that authority staff first submit a written report to the authority's senior officials (Article 39). The authority is required to keep confidential commercial secrets it receives in the process of enforcement (Article 41). Plans for staffing the authority are unclear, and the rivalry between MOFCOM and SAIC may not yet be fully resolved. Moreover, there is no indication in the law that the National Development and Reform Commission (NDRC) is relinquishing its price regulatory function. The law also provides for an anti-monopoly commission, but its roles are primarily research and coordination rather than policy making and implementation (Article 9).

Industry Associations

The law recognizes the roles of industry associations, which are largely quasi-governmental, with respect to industry self-discipline, guided competition and the safeguarding of market order (Article 11), but bars such associations from organizing companies to engage in monopoly conduct (Article 16). These provisions are partly a response to recent efforts by some industry associations to orchestrate industry-wide price increases.

Penalties

Fines for monopoly agreements and abuses of dominant position may range as high as one to ten percent of the wrongdoing company's total sales volume in the relevant market during the previous year (Articles 46 and 47). If the parties have not yet implemented a monopoly agreement, however, the fine will not exceed 500,000 RMB (about $66,000 USD) (Article 46). The law also provides for fines for undertaking a merger in violation of the law's notification requirement, also capped at 500,000 RMB (Article 48). The authority may also order divestitures and other steps necessary to restore competitive conditions that existed before the merger (Article 48). Finally, the law provides that civil remedies may be available to injured parties under other legislation (Article 50).

Conclusion

The law will become effective on August 1, 2008 (Article 57). Much will remain uncertain until the National People's Congress issues an interpretation of the law, the authority is established, and the authority issues implementing regulations. In the interim, companies that are active or wish to become active in China are well-advised to review their existing business practices to determine whether they comply with the law as written.

Although the law is more detailed than the basic competition statutes in the United States and the European Union, those statutes have been supplemented over the decades by a huge body of judicial decisions, administrative guidance and practical experience. It will take time to establish such a body of knowledge in China, particularly given the limited number of government officials with legal and economic training in competition law. The authority will, therefore, enjoy substantial discretion at the outset. This will be of particular concern with respect, for example, to intellectual property rights (IPR). The law provides that the exercise of IPR established in accordance with intellectual property law will not be subject to the law (Article 55), but the abuse of IPR will be subject to the law. Where and how the line between exercise and abuse is drawn will be of great concern to IPR holders.

Authors

Lester Ross

PARTNER

Partner-in-Charge, Beijing Office

lester.ross@wilmerhale.com

+86 10 5901 6588