Foreword

Like it or not, antitrust has gone global. A merger requiring antitrust clearance from multiple jurisdictions, a multinational company being fined on different continents for participation in a global price-fixing cartel, a technology firm negotiating licensing deals with companies located in different countries … such headlines often fill the business news. With antitrust going global, so is the regulatory risk. A merger between two companies based in two countries may have to abandon the deal if they cannot obtain antitrust approval from a third country. The discovery of a cartel in one country may lead to follow-on investigations and fines in other jurisdictions. A licensing practice that might seem quite benign in one jurisdiction could face hefty antitrust fines in another. The globalization of antitrust has seen both convergence in legal principles and divergence in enforcement practice across an increasing number of antitrust jurisdictions, adding more complexity to the practice that not long ago was still almost entirely local.

Against this backdrop is China's Anti-Monopoly Law, which has only been in force for the last seven years. Yet there is no doubt China has emerged as an important player in the global antitrust arena in virtually all major areas of enforcement: mergers and acquisitions, joint ventures, cartels, abuse of dominance, transfer and licensing of intellectual property rights, and administrative monopoly. MOFCOM, NDRC, SAIC, these acronyms have become the buzz words in the antitrust world, joining the ranks of DOJ, FTC, and EC. Management and legal counsel of foreign companies operating in China as well as those outside China with Chinese business desperately need to keep up with the fast-paced antitrust developments in the most dynamic market in the world.

The author of this book, Becky Koblitz, is a seasoned antitrust lawyer for a major U.S. law firm in Beijing. She has decades of legal experience as a prosecutor at the Antitrust Division of the U.S. Department of Justice, as well as in-house counsel for a German subsidiary of a major American real estate development company and as a lawyer at law firms globally. Her rich experience in the U.S., Europe and China, now often regarded as the three centers of global antitrust, makes her the perfect candidate to write a book on China's antitrust development. Her book is a quick read that tells what there is to know about China's antitrust enforcement and includes practical

advice and examples for the various aspects of antitrust: dealing with competitors, dealing within the supply chain, mergers, etc. She writes in a straight-forward language such that non-antitrust lawyers can get beyond stock phrases like "illicit price coordination," "abuse of dominance," or "unilateral effect." Her book is a valuable and practical "cookbook" for antitrust compliance training and beyond. Another feature of the book is that it provides both legal and economic perspectives on antitrust analysis in China, which is important given that economic analysis is increasingly adopted by China's antitrust agencies and the Chinese courts. Thus understanding the logic and methodology behind economic analysis as is applied to Chinese cases is key to conducting proper antitrust legal analysis that is tailored to the Chinese context.

To write a book on the burgeoning antitrust enforcement and practice for the constantly evolving Chinese market is a real challenge. The trick, and it is not as easy as you would think, is to write simple declarative sentences, understandable to the antitrust layman, and at the same time not lose the rigor of antitrust analysis. I think this relatively short book is a remarkable achievement in meeting such a challenge, but I invite you to judge for yourself.

Su Sun, Ph.D.
Vice President, Economists Incorporated

Preface

My father, Kosaku Nao, was a Hebrew and Old Testament scholar and President of the Japan Lutheran Church. When he was a young seminarian he had to learn Aramaic, Greek, German, English and, of course, ancient Hebrew, to study the Old Testament, sometimes having to jump from language to language in the secondary sources to understand a passage in the Bible. He then spent twenty-five years writing a Hebrew-Japanese Lexicon of the Old Testament so that all Japanese seminarians who followed him could go directly from the original to their own language. My book is by no means comparable in stature and it took a mere twelve months to draft. But I hope it saves some of you the effort of sifting through the internet and chancing through various articles and court cases to appreciate the basic issues and most prominent sources on Chinese antitrust law. If my father were still alive perhaps he would recognize some of his famous and invariably stubborn dedication in these pages.

Antitrust is the part of law that has always captivated me, even if circumstances diverted me to real estate, corporate law and financing. It is simply a twist of fate that I should be practicing law in China at precisely the time when they introduced the first Chinese antitrust law in the very long history of this noble land. The Chinese have not invented the principles of antitrust, and much of what happens here is familiar from practice in the United States and Europe. But this wouldn't be China if they didn't have their special way of doing things and antitrust law, like the law in general here, is in the process of evolution, even if it has been long since promulgated.

Jim Zimmerman, my colleague at Sheppard, Mullin, gave me the idea to write this book and never let me lose faith. I am also grateful to my husband, Don, who doubled as my muse and my stand-in for the all-suffering end-users of this book (if it ends up frustrating you, he's let you down). I am also grateful to my antitrust colleagues who have taken the time to read through my manuscript, catch me from egregious errors and save me from various lapses. The ones that remain are all mine.

Becky Nao Koblitz
Beijing, China
April 2015

CHAPTER 2

Enforcement Framework of China's Antitrust Law

§2.01 GENERAL BACKGROUND OF THE ANTI-MONOPOLY LAW

[A] Purpose

Similar to other jurisdictions, the Anti-Monopoly Law (AML) has as its purpose the safeguarding of healthy competition among companies in the market for the benefit of consumers. But due to China's political structure and the tendency towards heavy-handed state intervention in the Chinese economy, the AML also supports China's industrial policies.[1] The Chinese antitrust enforcers publically talk about how they must heed China's industrial policies while enforcing the antitrust laws. For example, as we will see later the AML appears to be used simply to force price reductions rather than increase competition. In practice, these non-competition considerations are evident in the way the AML is enforced by the government and to a lesser degree by the courts. Therefore as practitioners, it is prudent to adjust our clients' conduct to this environment. Our task must be to walk the fine line between both complying with the antitrust laws and supporting China's industrial policies and at the same time not compromising our clients' business interests.

1. *See* Art. 1 of Anti-Monopoly Law of the People's Republic of China (adopted August 30, 2007, at the 29th Meeting of the Standing Comm. of the 10th National People's Congress, effective August 1, 2008) [hereinafter the "AML"]: [the purpose of the legislation is to] "prevent and halt anti-competitive acts, ensure fair market competition, improve economic efficiency, safeguard the interests of consumers and the public interest, and promote the healthy development of the socialist market economy." Furthermore, the AML continues in Art. 4: "the State shall formulate and implement competition rules suitable for a socialist market economy, improve macro regulation, and enhance a uniform, open, competitive and orderly market system."

[B] Who Does This Apply to? Who Is Exempt?

The AML applies to all public and private enterprises in China, foreign companies doing business in China, nonprofit organizations, trade associations[2] and government administrative organs. In theory the AML applies to state-owned entities (SOEs) but in practice, the majority of the SOEs are out of the reach of the antitrust enforcement authorities. Under the AML the State protects, supervises and controls those SOEs in industries in strategic sectors that concern the national economy and national security.[3] The AML and its regulations do not identify which industries are in strategic sectors, but the State Administration for State Assets Commission (SASAC) interprets "strategic sectors" to encompass national security, major infrastructure and important mineral resources, industries that provide essential public goods and services, and high-tech industries. These are categorized as "exclusively controlled, obviously controlled and necessarily controlled" industries, specifically:[4]

- Exclusively controlled industries: military production, power grid, electricity, petroleum, petrochemical, telecommunications, coal, civil aviation and shipping.
- Obviously controlled industries: equipment manufacturers, motor vehicle, electronic information, construction, steel, nonferrous metals, chemical, reconnaissance and design and technology.
- Necessarily controlled industries: commerce and trade, investment, medicine, construction materials, farming and geological exploration.

In summary, much of China's economy remains State-owned and protected from the reach of the AML.[5]

2. Industry and trade associations are prohibited from encouraging or forcing their members to engage in monopolistic activities. AML Art. 16. The AML further requires industry and trade associations to engage in self-regulation of their respective industries in order to "safeguard the competitive order in the market." AML Art. 11.
3. AML Art. 7. "With respect to industries controlled by State-owned entities, as well as industries that concern the national economy and national security, the State shall protect, supervise and control the companies operating within these industries."
4. The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) published Guiding Opinions about Promoting the Adjustment of State-owned Capital and the Reorganization of State-owned Enterprises on December 5, 2006. The purpose of the opinions, to promote the concentration of state-owned capital on major industries and key fields and enhance the controlling power of state-owned economy, is repeatedly echoed in subsequent government regulations and guiding opinions, such as the January 2013 State Council Guiding Opinions. According to SASAC, the major industries and key fields mainly include: industries concerning national security, major infrastructure and important mineral resources, industries that provide essential public goods and services, as well as the key enterprises in pillar industries and high-tech industries. Chairman Li said that the references in the AML to "State-owned economy" and industries "concerning the lifeline of national economy and national security" or the industries "lawfully enjoying exclusive production" meant the exclusively controlled, obviously controlled and necessarily controlled industries. Chairman Li Rongrong's official interview by Xinhua News Agency on December 18, 2006, just after the issuance of the SASAC notice in 2006, available at *http://www.gov.cn/jrzg*.
5. SOEs are funded by the government and as a result, for the most part operate uneconomically because there is no incentive to minimize costs, be efficient and to innovate. Realistically, since the bulk of the foreign companies are operating in the obviously and necessarily controlled industries, it is fair to say that foreign companies can expect to face resistance from SOEs.

Trade associations can potentially be exempt from the AML when they are functioning as government entities that are "strengthening the self-discipline within the industry, leading companies toward lawful competition and maintaining the market competition order."[6] At the same time, trade associations are prohibited from organizing companies to carry out anticompetitive conduct such as issuing articles of association, rules, decisions, notices of standards that eliminate or restrict competition, or calling together, organizing or assisting members to reach any agreement, resolution, summary or memorandum that eliminates or restricts competition.[7] The AML is silent as to whether or not a member of an association can use the association's policies and resolutions as a defense for taking part in anticompetitive conduct.[8]

The AML does not preclude companies from lawfully exercising their intellectual property rights, but conversely the AML does prohibit companies from abusing their intellectual property rights to eliminate or restrict competition.[9]

The AML does not apply to agricultural producers and rural economic organizations that engage in concerted conduct with regard to production, processing, sales, transportation and storage of agricultural products.[10]

[C] What Is the Jurisdiction of the AML?

In addition to applying to activities that take place within the territorial limits of China, meaning mainland China which does not include Macau, Hong Kong and Taiwan,[11] the AML also applies extraterritorially to anticompetitive activities occurring outside of China that have the effect of eliminating or restricting competition in the Chinese domestic market.[12] It is applicable to anticompetitive activities that took place after August 1, 2008, when the AML became effective.[13] This means that even if an

6. AML Art. 11.
7. AML Art. 16. Rules Regarding Price-related Anticompetitive Conduct, National Development and Reform Commission, issued December 29, 2010, effective February 1, 2011 [hereinafter "NDRC price-related anticompetitive rules"], Art. 9. Rules Regarding Anticompetitive Agreements, State Administration for Industry and Commerce, issued December 31, 2010, effective February 1, 2011 [hereinafter "SAIC anticompetitive agreement rules"], Art. 9.
8. For example, in the context of the AML's prohibition against abuse of administrative power (similar to state action in the United States) a company cannot defend its conduct by saying it was following a local government's administrative policy if the policy itself is a violation of the AML.
9. AML Art. 55. On April 7, 2015 the State Administration of Industry and Commerce (SAIC) issued rules that explain what type of conduct would qualify as an unlawful exercise of intellectual property rights with respect to the antitrust laws. This will be discussed further in Ch. 7 (Intellectual Property rights).
10. *Id*. at Art. 56.
11. Mainland China has different legal systems from Macau, Hong Kong and Taiwan. The National People's Congress of China authorizes Hong Kong and Macau to exercise a high degree of autonomy both in terms of legislative and judicial power. There is no statutory definition of "mainland China."
12. *Id*. at Art. 2.
13. There is overlap with the Price Law of the People's Republic of China (adopted December 29, 1997, at the 8th National People's Congress, effective May 1, 1998) [hereinafter the "Price Law"]

agreement that is the basis of an alleged anticompetitive conduct was signed before the AML came into effect, if the conduct and alleged anti-competitive effects of the agreement took place after August 1, 2008, then the AML would apply to the alleged violation.[14]

[D] What Is Prohibited?

While there is nothing wrong with companies expanding to enhance their competitiveness, like antitrust laws in the United States and Europe, the AML is based on the premise that maintaining fair competition is good for the economy and good for consumers.[15] The AML protects the process of competition for the benefit of the consumers by making the following unlawful: agreements that restrict or eliminate competition, abusing a dominant position in a relevant market to restrict or eliminate competition (commonly known as monopolization), transactions that have the potential to restrict or eliminate competition and using a government administrative organ to restrict or eliminate competition.[16]

In the text of the AML, the term "monopoly" is used in a very broad sense to include price-fixing agreements and other conduct that restricts competition,[17] in contrast to the United States where "monopoly" or "monopoly power" is understood as the status of "holding of such dominance within an industry as to command the power to fix or control prices in or exclude competition from the industry."[18] Therefore, a "monopolist" is a company with significant and durable market power, i.e., long term ability to raise prices or exclude competitors and "monopolization" is defined as market power plus exclusionary or predatory acts without business justification.[19]

but no guidance about when the AML or the Price Law will be used. If the anticompetitive activities pre-dated the AML as in the case of the price-fixing case involving manufacturers of liquid crystal displays (the companies were investigated and fined in 2013, *see* discussion in Ch. 3, §3.03 [A] *infra*) the Price Law will be enforced.

14. Liang Ding, *After Many Twists and Turns China's First Vertical Monopoly Agreement Dispute has Ended—Comments on Rainbow v. Johnson & Johnson*, Wolters Kluwer China, August 5, 2013. In this case, the Shanghai High Court held that even though the distribution agreement that is the subject of the lawsuit was entered into on January 2, 2008, since the parties continued performance under this agreement when the AML came into effect in August 2008, the AML should be applicable to the case.
15. AML Art. 5.
16. This prohibition is derived from the AML prohibition against government administrations misusing official positions to restrict or eliminate competition: as a consequence of this prohibition enterprises are also liable for misconduct if they use these administrative actions as a means of achieving goals prohibited under the AML. This is discussed further in Ch. 8, §8.02 *infra*.
17. AML Art. 3 states that "monopolistic conduct" include "monopoly agreements between entities, abuse of dominant market position, and mergers that may have the effect of eliminating or restricting competition." In Art. 13 "monopoly agreements" refers to agreements, decisions or other concerted behavior that may eliminate or restrict competition. Hence "monopoly" is used in terms of being anti-competitive.
18. *See* Earl W. Kintner & Mark R. Joelson, AN INTERNATIONAL ANTITRUST PRIMER (Macmillan Publishing Co., Inc., 1974), at p. 85.
19. *See* Federal Trade Commission, SINGLE FIRM CONDUCT, available at *www.ftc.gov*, s. 1 Monopolization Defined.

Therefore, for purposes of this handbook the term "anticompetitive" will be used instead of "monopoly" when dealing with situations other monopolization, also referred to as abuse of dominant position.

Since the Chinese legal system is statutory rather than a common law system, it relies heavily on what is explicitly stated in laws and regulations. This contrasts with the United States, where we would refer to case law for examples of violations, defenses and justifications. Furthermore, rather than having broad general descriptions of prohibited conduct, the AML lists examples of prohibited conduct. Although there is no *stare decisis* system officially, the Chinese enforcers and judiciary and bar are intensely interested in precedent decisions in China that can be quite influential. Moreover, the Chinese are aware of cases in other jurisdictions as a result of the interaction on an international level between the law enforcement agencies, judiciary and bar. There is a trend toward incorporating methods of analysis used in other jurisdictions. The four broad AML prohibitions are discussed below. In the subsequent Chapters 3–8 these prohibitions will be discussed in terms of what impact the actual government investigations and court cases could have on companies doing business in China.

[1] Agreements among Competitors and within the Supply Chain That Restrict or Eliminate Competition

Similar to the United States and EU, the AML prohibits cartels and anticompetitive agreements among competitors. The AML specifically lists examples of such prohibited agreements, including those that fix prices, limit output or sales volumes of products, allocate purchasing markets or sales markets, restrict the purchase of new technology or new facilities or restrict the development of new technology or new products, and finally, implement group boycotts.[20] Although bid-rigging is not specifically listed, it would fall under price-fixing or allocation of markets. All of these agreements are commonly referred to as "horizontal agreements" because they are among competitors.

The AML also addresses agreements that generally occur within the supply chain, commonly referred to in the United States and EU as "vertical restraints," in two sections of the AML: vertical restraints in the form of agreements related to pricing and vertical restraints in the form of monopolistic conduct (which will be discussed below in paragraph §2.01[D][2]). With respect to the vertical agreements related to pricing, the prohibited agreements listed in the AML are those that fix the price of goods sold to third parties or limit the minimum price at which goods can be sold to third parties.

20. Unlike the broad language of Sherman Act that prohibits "[e]very contract, combination, in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations," AML Art. 13 and the subsequent regulations issued by the National Development and Reform Commission (NDRC) and SAIC, list specific types of prohibited agreements and have a catch-all description for other agreements.

These prohibitions will be discussed from a practitioner's perspective in Chapter 3 (Interaction with Competitors) and Chapter 4 (Conduct within the Supply Chain—Resale Price Maintenance).

[2] Using a Dominant Position in a Market to Restrict or Eliminate Competition (Commonly Known as Monopolization)

Similar to other jurisdictions, merely being the biggest company in a market is not bad. Becoming big because of business acumen and innovation is legitimate. The antitrust risk arises when a company has so much influence over the market place such that it excludes other companies without any business justification and thus harms competition. The AML describes such a situation as abuse of dominance, the U.S. antitrust law refers to this as monopolization.

The AML prohibits a company that has a dominant position in the relevant market from selling products at unfairly high prices or buying products at unfairly low prices; as well as engaging in the following conduct without justification: selling products at prices below cost, refusing to trade with other companies, entering into exclusive dealing agreements, entering into tying agreements (selling one product on the condition that another product is also purchased) or imposing other unreasonable conditions, discriminating (giving one party better prices or terms of business when dealing with parties with equal standing) based on price or other trading conditions.[21]

This prohibition will be discussed from a practitioner's perspective in Chapter 5 (Conduct within the Supply Chain—Monopolization).

[3] Transactions That Have the Potential to Restrict or Eliminate Competition

Similar to other jurisdictions, the AML has a merger control component to prevent in advance mergers that would enhance the ability, motive and possibility of an entity to eliminate or restrict competition.[22] As such, the AML has threshold requirements related to the size of the parties and type of transaction. Transactions that do not meet these thresholds would theoretically not pose anticompetitive issues and can be consummated without going through the notification process, thus reducing the number of transactions that must be reported prior to filing. In China, recently a simplified premerger notification procedure was introduced with the hope that those transactions that meet a set of criteria are processed more quickly. Both the simplified and normal procedures are discussed below in section §2.03[B][2] and the issues that arise in merger review are discussed in Chapter 6 (Merger Review).

21. AML Art. 17.
22. *Id.* at Art. 28.: The AML prohibits mergers when the effect "will or may eliminate or restrict competition." Interim Provisions Regarding the Assessment of the Effects of Mergers, issued by Ministry of Commerce August 29, 2011, effective September 3, 2011 [hereinafter "interim assessment provisions "], Art. 4.

[4] Using a Government Administrative Organ to Restrict or Eliminate Competition

The AML prohibits government administrative organs from misusing their official positions to restrict or eliminate competition. Specifically, local government entities are prohibited from forcing companies or individuals to deal exclusively with companies designated by the government entity, blocking inter-regional trade, discriminating in the context of tendering and bidding activities, discriminating in the context of investing and establishing local branches, forcing companies to engage in anticompetitive conduct that is forbidden by the AML, and from passing provisions that would eliminate or restrict competition.[23] This prohibition will be discussed in Chapter 8 (Abuse of Administrative Power).

[E] What Is the Statute of Limitations for Enforcing a Violation?

There is no statute of limitations for AML violations investigated by the government.

[F] What Are the Penalties for Violating AML? The Violation of AML May Lead to Administrative Liability, Criminal Liability and/or Civil Liability

[1] Administrative Liability

When the investigation is not withdrawn (no basis for investigation), suspended, or terminated based on an exemption, the company will face administrative penalties for violating the AML. There are no criminal sanctions for AML violations (except for non-compliance with the investigation, *see* discussion below).[24] The penalties for violating the AML are relatively low in comparison to the United States and EU (although the fines are on the rise in China), however, the damage to a company's image or brand and costs to defend the company may both be substantial. In general, the enforcement agencies will consider such factors as the nature, extent and duration of the violations when determining the specific levels of fines related to anticompetitive agreements, monopolization and illegal mergers. The penalties are as follows:

- **In matters related to anticompetitive agreements such as price-fixing cartels or retail price maintenance agreements**: the enforcement agency can order the companies to cease and desist, confiscate illegal gains and impose a fine of from 1% up to 10% of sales revenue made in the previous year. In practice the sales revenue is limited to business in China. Furthermore, the

23. *Id.* at Arts. 32–37.
24. Under the Criminal law there is criminal liability for bid-rigging, but there is no cross-reference in the AML to the Criminal Law with regard to bid-rigging. In the PRC Criminal Law, under Art. 223 there is also no specific reference to the AML, only a description of the offense of bid-rigging. *See* Criminal Law of the People's Republic of China (adopted July 1, 1979, at the 2nd Sess. Of the 5th National People's Congress, revised for the 8th time on February 25, 2011, effective May 1, 2011) [hereinafter the "Criminal Law"].

CHAPTER 3

Interaction with Competitors

§3.01 BACKGROUND: GENERAL ANTITRUST CONCEPTS RELATED TO RELATIONSHIPS WITH COMPETITORS

In the real world competitors interact with each other: competitors are members of trade associations, are joint venture partners, they collaborate with each other to purchase supplies, jointly finance R&D, coordinate usage of manufacturing facilities and are invited to the same parties or have similar circle of friends, etc. etc. It is unreasonable and impractical to prohibit all interactions among competitors—nor does it make economic sense, since there are situations that result in better use of resources. For example, if one company has excess capacity, it would make sense to let a competitor use this capacity rather than let it go to waste. In general, from an antitrust perspective, price-fixing, market allocation and bid-rigging are hard core antitrust violations that are "unambiguously harmful" because they defraud customers, raise prices or restrict output without any offsetting benefit to the customer[1] and thus are presumed to be illegal. Defendants are not given the opportunity to offer evidence to demonstrate the reasonableness or necessity of the challenged conduct.[2] But in the context of a joint venture between two competitors, it is generally acceptable for the joint venture to set the price of a product that is produced by the joint venture because this is considered price setting by a single entity rather than fixing the price of competing products manufactured by competitors.

1. Department of Justice Antitrust Division, ANTITRUST PRIMER FOR FEDERAL LAW ENFORCEMENT PERSONNEL, August 2003, revised 2005, p. 4.
2. *Id.* "Thus companies may not justify price fixing by arguing that such price fixing was necessary to avoid cutthroat competition, or that it actually stimulated competition, or that it resulted in reasonable prices. The essence of price fixing, bid rigging and market allocation is simply this: the consumer believes he or she is making a purchase in a competitive market when, in reality, the conspirators secretly agreed not to compete."

§3.02 PROHIBITIONS UNDER THE ANTI-MONOPOLY LAW

Similar to the U.S. and EU antitrust laws, the Anti-Monopoly Law (AML)[3] prohibits anticompetitive agreements among competitors and lists examples of such types of agreements, like those that fix prices, limit output or sales volumes of products, allocate purchasing markets or sales markets, restrict the purchase of new technology or new facilities or restrict the development of new technology or new products, and, finally, those that implement group boycotts.[4] Although bid-rigging is not specifically listed, it would fall under price-fixing or allocation of markets.

[A] Explicit Agreements and Agreements Inferred from Conduct

Similar to the U.S. and EU, agreements can be either explicit or inferred from conduct.[5] An example of an explicit price-fixing agreement is where competitors meet and agree on price margins or price increases, documenting the agreement in minutes or email correspondence between the competitors. In contrast, there is the following scenario: at a social event one competitor announces that it will raise prices next month, the other competitors in the room remain silent and the next month within a period of one week every competitor that was present at the social event raises its price. In such a situation a price-fixing agreement can be inferred from the concerted action of all the competitors. Under the AML, concerted action can be implied by looking at such factors as:

3. Anti-Monopoly Law of the People's Republic of China (adopted at the 29th Session of the Standing Committee of the 10th National People's Congress on August 30, 2007, effective August 1, 2008). [hereinafter "AML"].
4. Unlike the broad language of Sherman Act that prohibits "[e]very contract, combination, in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations," Art. 13 of the AML and the subsequent regulations issued by the National Development and Reform Commission (NDRC) and State Administration for Industry and Commerce (SAIC), all list specific types of prohibited agreements as well as a catch-all description for other agreements. Specifically, Art. 13 of the AML sets forth the general prohibitions related to dealings with competitors (often referred to as horizontal relationships), prohibiting agreements that:

   (1) fix or change prices of goods ("prices" covers price spreads, discounts, standard formula for pricing, transactions with third parties based on a specific price),
   (2) restrict the quantity of production or the sales volume of goods (e.g., curtail or stop production, set the output level, refuse to supply, restrict amount supplied),
   (3) allocate supply markets of raw material or sales market,
   (4) restrict purchasing of new technology or new facilities or restrict developing new technology or new products (includes restricting investing in development of new technologies, refusing to adopt new technical standards),
   (5) jointly boycott transactions (includes preventing a company from dealing with a competitor), and
   (6) the catch-all "other anticompetitive agreements" as determined by the enforcement agencies.

5. AML Art. 13 defines anticompetitive agreements as those "agreements, decisions or other concerted behavior that may eliminate or restrict competition."

- Whether the companies raise or lower prices in tandem.
- To what extent (business goals and other similar information) the companies communicated business goals and other similar information to each other.
- The dynamics of the relevant market structure (who are the players in the market/how competitive is the market/changes in the market).
- Whether the companies are able to justify their concerted action. For example, was there a price increase for all companies in the same industry because the supply of raw material was reduced due to natural disaster such as a drought? If so, one cannot imply an anticompetitive agreement in violation of the antitrust law.[6]

In Chinese business, explicit anticompetitive agreements are not controversial. The business culture in China traditionally includes open discussion of internal business goals and "gentlemen's agreements" regarding allocation of customers or markets are not unusual to assure "harmony" in the business. Furthermore, the concept of conflict of interests is not engrained in the culture. The challenge for foreign companies doing business in China is that this combination is a perfect breeding ground for collusion to fix prices, allocate markets, rig bids, etc.

[B] Unique Situation in China

[1] Joint Ventures as Competitors

Another unique situation in China is that, due to investment regulations in certain industries, foreign companies are not allowed to have a controlling interest in a subsidiary—they are in fact forced to form joint ventures with a Chinese company.[7] Therefore, if the foreign company has, for example, two joint ventures with two

6. *See* Rules Regarding Price-related Anticompetitive Conduct, National Development and Reform Commission, issued December 29, 2010, effective February 1, 2011 [hereafter "NDRC price-related anticompetitive rules"] and Rules Regarding Prohibition of Anticompetitive Agreements, State Administration for Industry and Commerce, issued December 31, 2010, effective February 1, 2011 [hereafter "SAIC anticompetitive agreements rules"]. *See* Art. 6 of NDRC price-related anticompetitive rules provides factors to consider when determining whether or not there is a concerted act: uniformity of price-related actions of the companies, whether companies communicate their intentions, market structure, and changes in the market. And Art. 3 of SAIC anticompetitive agreements rules provides factors to consider when determining whether or not there is a concerted act: uniformity of price-related actions of the companies, exchange of intention or other information among the companies, whether companies have a reasonable explanations for any uniform activities, as well as information about the market structure, competitiveness status within the relevant market, changes in the relevant market and the status quo of the relevant industry.
7. The following four industries include sub-industries in which joint ventures and Chinese-foreign cooperation is required: transportation, warehousing and postal service; electric machinery and equipment manufacturing, mining; and education. Catalogue on Industry Guidelines for Foreign investment (2015 Revision) (Order No. 22, issued by the National Development and Reform Commission and Ministry of Commerce on March 10, 2015, effective April 10, 2015). For general discussion about foreign investment guidelines *see* Ch. 5 of James M. Zimmerman, CHINA LAW DESKBOOK: LEGAL GUIDE FOR FOREIGN-INVESTED ENTERPRISES. Fourth Edition (American Bar Association, 2014).

different Chinese partners and controls neither but still engages in the same business, the two joint ventures can be considered competitors in the Chinese market. Any coordination of prices, markets, customers, bidding, etc., could potentially violate the AML.

[2] Industry Associations Request Information

Companies often confront the more ambiguous situations such as exchanges of information. An exchange of information alone is not prohibited by the AML. However, when there is an exchange of information and uniformity of conduct among competitors, it could potentially constitute "concerted" action under the AML. For example, in China, industry associations often collect sales and production information from members who are naturally all competitors. The associations make the information available to all the members. Whether such information exchange would be considered a concerted action in violation of the AML is dependent on an additional factor of subsequent uniformity of action among the members. For example, based on this information, the members could restrict the output of the product they compete in, allocate market share among the members or restrict/delay development of new technology or a new product. In China foreign companies need to cooperate with requests from industry trade associations since they are quasi-governmental entities and could affect how a company's business continues to function in China. Providing aggregate sales and production numbers without any information that may signal future plans is probably a safe way to respond to such surveys or requests from industry associations, since information in such form is not particularly useful for competitors in terms of planning price-fixing activities.

[C] "Per Se" or "Hard Core" Is Inferred through Exemptions

Neither the AML nor any subsequent regulations and guidelines use the terms "per se" or "hard core" violations, by which we mean violations that cannot be justified, with respect to these horizontal agreements. The agreements listed in AML Article 13 (those that fix prices, limit output or sales volumes of products, allocate purchasing markets or sales markets, restrict the purchase of new technology or new facilities or restrict the development of new technology or new products, and finally, implement group boycotts), are presumed to be anticompetitive and in violation of the AML by virtue of the existence of exemptions since "exemption" infers the pre-existence of a violation: an exemption, in and of itself, implies that the conduct is wrong—otherwise the party would not need an exemption. Under the AML, anticompetitive agreements whose pro-competitive effects outweigh the anticompetitive effects will be *exempt* from the application of the AML. The industrial policy prong of the AML underlies this system of exemptions.[8] There are two categories of circumstances for exemptions:

8. *See* article by SHANG Min, Director General of Anti-Monopoly Bureau of MOFCOM, *Antitrust in China*, COMPETITION LAW INTERNATIONAL, February 2009, p. 7: "...the AML not only fully draws on the internationally recognized antitrust practices, but also takes into consideration China's current situation and the state of its economic development. Certain agreements that display benefits for the economic development and public interest without significantly impairing competition are exempted from the prohibition."

circumstances related to domestic needs and those related to foreign trade. The domestic needs have two aspects. The first is the economic development of China, for example, improving technology and quality of products, bolstering the competitiveness of small and medium-sized companies. The second is protecting China's public interest, for example, conserving energy, protecting the environment, aiding in disaster relief and dealing with economic recession.[9] Even if the alleged anticompetitive agreement meets the requirements for exemptions related to domestic needs, the parties to the alleged anticompetitive agreement must still show that such agreement does not *substantially* restrict competition in the relevant market and benefits consumers. The term "substantially" is neither defined in the AML nor in subsequent regulations.

The exempt purpose related to foreign trade is "to protect justifiable interests of foreign trade or foreign economic cooperation."[10] If the purpose of the alleged anticompetitive agreement meets the foreign trade related requirement for being exempt from the application of the AML, the parties to the alleged anticompetitive agreement do not need to provide further information. The foreign trade related exemptions benefit the domestic companies whose conduct is allegedly anticompetitive. In addition, there is the catch-all exemption based on other circumstances prescribed by the law or State Council.[11] In practice, no company investigated for horizontal anticompetitive agreements has been exempt from the application of the AML.

§3.03 ENFORCEMENT

[A] Government Investigations

In 2010, two years after the AML came into effect the National Development and Reform Commission (NDRC) concluded the first antitrust conduct investigation, a

9. AML Art. 15:
   a) to improve technologies, research and development of new products; or
   b) to upgrade product quality, reduce costs, improve efficiency, unify product specifications/standards, or carrying out professional labor division; or
   c) to enhance efficiency of operations and reinforce the competitiveness of small and medium-sized companies; or
   d) to realize public interest goals such as conservation of energy, environmental protection and disaster relief; and
   e) to mitigate the severe decrease in volume of sales or obvious excess in production during economic recessions.
10. *Id.* at Art. 15(6).
11. *Id.* at Art. 15(7).

price-fixing cartel among thirty-three producers of rice noodles.[12] The State Administration for Industry and Commerce (SAIC) concluded its first antitrust conduct investigation in 2011, dealing with a trade organization for concrete companies that organized a market allocation. To put things in perspective, once the AML was issued, the NDRC and SAIC needed time to adjust to their new responsibilities, train their staff and draft their respective regulations regarding the enforcement of anticompetitive conduct. These regulations became effective in 2011, giving companies a better understanding of how the agencies would enforce the AML and the different levels of leniency alleged violators could strive for. Since then the number of investigations have increased but uncertainty continues to exist with regard to how the AML is enforced and due process for those investigated. The following discussion focuses on the enforcement issues. The due process issues were discussed in Chapter 2 (Enforcement Framework) in the section on investigations (§2.03[A]) *supra*.

The first case involving foreigners was concluded by the NDRC in 2013. Six foreign manufacturers of liquid crystal displays (LCD) were found to be part of an international conspiracy to fix LCD prices. The Chinese enforcers were able to bring this case as a result of working with other antitrust enforcement agencies from other jurisdictions. Although the case was brought under the Price Law[13] because the AML was not in effect when the conduct took place, it is considered an antitrust price-fixing case. In 2014 the NDRC found Japanese auto parts and bearings manufacturers guilty of price-fixing. This was also a result of Chinese enforcers benefiting from investigations initiated in other jurisdictions.[14]

The NDRC conducts both informal and formal investigations (see discussion on these two forms, Chapter 2 (Enforcement Framework) in the section on investigative procedures (§2.03[A]) *supra*. The NDRC has been more aggressive than the SAIC. There is little transparency in terms of how decisions are made, since it is not mandatory under the law to publish information after companies are fined. What has been publicly available up until the fall of 2014[15] has little value in terms of methods of

12. March 2010 (price-fixing) The Guangxi Rice Noodle Cartel involving thirty-three producers of rice noodles was the first case in which the NDRC imposed a fine under AML Art. 13 and Art. 46 which provides for leniency for cooperation. Some of the members involved avoided punishment by providing cartel clues to the NDRC.
13. Price Law of the People's Republic of China (adopted December 29, 1997, at the 8th National People's Congress, effective May 1, 1998) [hereinafter the "Price Law"].
14. Although the neither the Chinese nor U.S. authorities comment on cooperating in the LCD and auto parts investigations, a number of the auto parts supply companies fined in China were also found guilty in the United States and the EU of price-fixing. It would be a logical step for the Chinese authorities to investigate the companies that were targeted by the U.S. and the EU antitrust authorities.
15. In the summer and fall of 2014 there were a series of complaints on behalf of foreign business interests, including reports by the U.S.-China Business Council and U.S. Chamber of Commerce and statement by the European Union Chamber of Commerce, raising concerns about discrimination against foreign companies. Subsequently the NDRC published its notice regarding a price-fixing investigation of domestic insurance companies that was closed six months earlier. The NDRC also published a notice regarding a price-fixing investigation of foreign auto parts and bearings manufacturers. Both notices were more detailed than in the past. NDRC's increased transparency may be partially in response to the State Council's new guidelines calling for more transparency in when administrative agencies disclose administrative penalty information, 2014

analysis or theories of antitrust because announcements are summary in nature, covering names of the companies, indicating the industry, what they did, which article of the AML they violated, and what their fine was. The government officials publicly talk about the investigations in terms of the fines they imposed and how they are serious about enforcing the AML, but offer little guidance as to whether they would accept business justifications for certain practices such as buyers' purchasing groups, which are not necessarily per se illegal in the United States. So far, the cases that have been concluded in China have involved price-fixing,[16] bid-rigging,[17] allocation of

Guidelines regarding Public Disclosure of Government Information issued by General Office of the State Council on March 17, 2014 effective March 17, 2014.

16. The following is not an exhaustive list, but shows the types of cases that have been investigated:
    (a) NDRC 2011(example of horizontal agreement between companies to use a vertical restraint) Two pharmaceutical companies allegedly conspired to raise price of promethazine hydrochloride, an ingredient for medicine to treat high blood pressure. Weifang Shuntong Pharmaceutical Factory Co. and Weifang Huaxin Pharmaceuticals Trading companies signed exclusive dealing agreements with the only two national suppliers of promethazine hydrochloride. In these exclusive dealing agreements the two suppliers agreed not to sell promethazine hydrochloride to any third parties without the permission of Shuntong and Huaxin. After controlling the supply of promethazine hydrochloride, Shuntong and Huaxin raised the price of promethazine hydrochloride more than six-fold from RMB 200 per kilogram to RMB 1,350 per kilogram. As a result, dozens of manufacturers of the hypertension medicine were forced to halt production or use raw materials they held in stock to maintain normal supplies. NDRC fined Shuntong RMB 6.5 million and Huaxin RMB 100,000 and confiscated illegal gains of RMB 429,000. *See* web site of NDRC, available at *http://www.sdpc.gov.cn/*.
    (b) NDRC 2013 (price-fixing) First case involving foreign companies and international price-fixing conspiracy. Six international liquid crystal display (LCD) manufacturers were fined. The cartel was investigated under the Price Law because the infringing activities took place before the AML was in effect. Nonetheless this case is considered relevant with regard to the AML because the NDRC's actions dovetailed price-fixing investigations of other jurisdictions. *See* web site of NDRC, available at *http://www.sdpc.gov.cn/*.
    (c) NDRC 2013 (price-fixing) Twenty-three insurance companies and a local trade association allegedly fixed car insurance premiums and handling fees between 2009 and 2010. *See* web site of NDRC, available at *http://www.sdpc.gov.cn/*.
    (d) NDRC 2014 (price-fixing) Auto parts and bearings cases. There were two price-fixing conspiracies involving foreign companies. The first conspiracy was among eight auto parts manufacturers and the second among four bearings manufacturers. The auto parts conspiracy allegedly took place between January 2000 and February 2010, when the companies held meetings in Japan to agree on prices to minimize competition when selling to car manufacturers. Among the products discussed included products sold in China. The eight auto parts manufacturers continued to sell these products under these agreements until the end of 2013. The second conspiracy was among four bearings manufacturers. The bearings conspiracy allegedly took place between 2000 (no month was given) and June 2010, when meetings were held in Japan and Shanghai to discuss price increase strategies, timing and range of price increases and implementation of price increase strategies. Prices in China were increased based on pricing information that was exchanged or agreements reached in these meetings. The NDRC concluded that these price-fixing agreements harmed the downstream manufacturers and Chinese consumers. *See* web site of NDRC, available at *http://www.sdpc.gov.cn/*.
    (e) NDRC 2014 (price-fixing) Three full-service dealers for a foreign automobile manufacturer allegedly agreed to fix the prices of auto sales and repairs. *See* web site of NDRC, available at *http://www.sdpc.gov.cn/*.
17. SAIC 2013(bid-rigging) Forty-two companies were found guilty. There was an open tender notice for house demolition services and there was a total of forty-four bidders. Two secret

CHAPTER 6

Merger Review

§6.01 BACKGROUND

[A] Enforcement Agency Responsible for Merger Review: Ministry of Commerce

The Ministry of Commerce (MOFCOM) is responsible for merger review and is the most professional and the most adept at competition analysis of the three Chinese agencies involved in antitrust enforcement. MOFCOM is open to input from other jurisdictions as well as foreign economists and applies many of the same tests and analyses. Over the first six years that the Anti-Monopoly Law (AML)[1] has been in effect, 97.4% of the mergers were unconditionally approved. Of the remaining 2.6% two were rejected, and twenty-four were conditionally approved.[2] The completed reviews of acquisitions by the first half of 2013 were in the following categories of parties: domestic-domestic (18%), foreign-domestic (62%) and foreign-foreign (55%). The completed reviews of non-acquisitions (mostly joint ventures) were in the following breakdowns: domestic-domestic (10%), foreign-domestic (50%) and foreign-foreign (40%). As such, it can be said that MOFCOM is not "targeting" foreign companies only.[3] In addition, in 2014 a Chinese state-owned entity was fined for failing to report a merger that should have gone through the pre-merger review process.[4] Nonetheless,

1. Anti-Monopoly Law of the People's Republic of China (adopted at the 29th Session of the Standing Committee of the 10th National People's Congress on August 30, 2007, effective August 1, 2008). [hereinafter "AML"].
2. *See* MOFCOM official site. Between August 2008 and September 2014 there were a total of 902 merger filings.
3. Fei Deng & Cunzhen Huang, *A Five Year Review of Merger Enforcement in China*, ANTITRUST SOURCE, October 2013, p. 3.
4. Unigroup, a state-owned entity that manufactures integrated circuits acquired RDA Microelectronics (RDA), a Chinese radio-frequency integrated circuit manufacturer. Unigroup did not make the pre-merger filing before concluding the transaction in July 2014. MOFCOM investigated this

suspicions that Chinese firms have sometimes evaded antitrust review for their mergers still abound.[5]

However, it is also true that mergers involving foreign parties have been the only ones denied or conditionally approved. It could be in part because foreign companies tend to be in mergers in highly concentrated industries. But it is also doubtless a reflection of the MOFCOM pursuing Chinese industrial policy. Another way to interpret the seemingly industrial policy-driven decisions is to say that MOFCOM has been influenced by Chinese companies and industrial associations or by its own historical roots in economic planning.[6] I should note, however, that this is not unique to China: in the 1980s, American businesses successfully lobbied to politicize antitrust enforcement and to revise the Department of Justice (DOJ)/Federal Trade Commission (FTC) Horizontal Merger Guidelines to make it easier for them to compete against Japanese companies.[7] MOFCOM, like antitrust agencies in most other jurisdictions, tries to balance sound economic and legal analysis against the lobbying of the business community and the national interests of the host nation.

Foreign companies are most likely to fall victim to this pursuit of Chinese national interest when their proposed merger, as shown by the many traditional merger analyzes, is seen as anticompetitive. But also where the U.S. and EU counterparts have taken a "wait and see" stance, as well as in terms of aspects of transactions that U.S. and EU counterparts conclude are not merger-specific, MOFCOM nevertheless included in their merger review. Thus, companies considering mergers with Chinese implications should start their analysis with much the same competitiveness review as would be done in the U.S. and Europe. On top of that they should add an analysis of potential conflicts with Chinese industrial policy goals.

[B] Underlying Concepts of Merger Review

Merger review is all about predicting what could happen after the merger, and in an ideal world, balancing the potential harm against potential benefit to competition in the relevant markets. The starting point for all jurisdictions is the same: mergers or acquisitions themselves are not necessarily bad. In fact, they can have the advantage of diversifying a business, joining complementary product lines, integrating resources

transaction (MOFCOM did not state how it found out about this transaction). In December 2014, after deciding that there were no anticompetitive issues, MOFCOM fined Unigroup RMB 300,000.

5. Yuni Yan Sobel, *Domestic-to-Domestic Transactions—A Gap in China's Merger Control Regime?* ANTITRUST SOURCE, February 2014. The article found "a potential gap between filings for domestic-to-domestic transactions compared to their foreign counterparts." *See* at p. 12.
6. *See* discussion in this chapter regarding supply of raw materials, intellectual property, industries important to China, *supra*.
7. Deborah A. Garza, *Market Definition, the New Horizontal Merger Guidelines, And the Long March Away from Structural Presumptions*, The ANTITRUST SOURCE, October 2010, at p. 3, "Almost as soon as the 1982 Guidelines were released, however, they were revised to respond to concerns that the overly rigid application of HHI thresholds would erroneously prohibit mergers that in particular, would enable U.S. based firms to compete more effectively in world markets (at the time the concern centered on more efficient Japanese firms). The business community desired a more nuanced analysis albeit at the necessary expense of certainty."

and increasing efficiency and productivity.[8] However, mergers can be harmful to competition if the number of major players in the market is reduced to the extent that the new firm controls a very significant share of the market, eliminates competitors, or makes it difficult for new firms to enter the market. Likewise, the underlying concept for assessing a merger or acquisition –regardless of the jurisdiction—is the *potential functional impact* that the merger and acquisition would have on competition within the context of the *relevant market* structure.

[1] Relevant Market

[a] Substitutability

Substantively, in theory, MOFCOM takes a similar analytical approach to merger review as other jurisdictions. The AML defines "relevant market" as "product scope or geographical scope within which the enterprises compete against each other during a certain period of time for specific products."[9] More detailed information of how to determine the relevant market is found in a subsequent AML guideline (AML Relevant Market Guideline), that adopts concepts and methods used by other antitrust regimes,[10] for example, the premise that a company will face the strongest competition from products that are close substitutes for the company's products.[11] A firm suspected of monopolistic practice will try to include as many substitutable competing products as possible when defining the relevant market. Substitutability can be analyzed by looking from both demand[12] and supply perspectives.[13] Demand substitutability looks at the degree of substitution according to the products' functions and uses, quality, price acceptance and availability to the consumer. Supply substitutability looks at producers and how easy it is in terms of investment, such as retrofitting production facilities, for other producers to enter the market.

[b] Hypothetical Monopolist Test

If it is difficult to determine the relevant market based on the above, the AML guidelines suggest using the hypothetical monopolist test, a tool also commonly used in other mature jurisdictions and also referred to as the "Small but Significant

8. *See* Interim Provisions Regarding the Assessment of the Effects of Mergers, issued by Ministry of Commerce August 29, 2011, effective September 3, 2011 [hereinafter "interim assessment provisions"]. These provisions mention the benefits of merger: integrate resources and R&D and have positive impact on technological progress (Art. 8); increase economic efficiency, achieve economies of scale and scope, reduce costs of the product, and enhance product diversification (Art. 9); increase competition in the relevant market, improve quality of product, and reduce prices (Art. 10); and promote development of the national economy (Art. 11).
9. AML Art. 12.
10. Guideline of the Anti-monopoly Committee of the State Council for the Definition of the Relevant Market, issued May 24, 2009, effective May 24, 2009 [hereinafter the "AML Relevant Market Guideline"].
11. *Id.* at Art. 4.
12. *Id.* at Art. 5.
13. *Id.* at Art. 6.

Non-transitory Increase in Price" (SSNIP) test.[14] This test is relevant because although MOFCOM has not explicitly stated that it uses this analysis in its decisions, given the trend in MOFCOM's embracing of different economic tools, this should not be ignored. This test helps identify a relevant market by finding the point where a hypothetical monopolist can no longer increase the price of its product without losing profits. The "small but significant" aspect of the price is commonly 5% and the "non-transitory" aspect is generally one year although none of the jurisdictions have a set rule. The analysis for defining the relevant market for the two parties to a proposed merger that manufacture product A is as follows. The initial question is: What other manufacturers of product A or products that are close substitutes for A should be included in this relevant market? Once a group of products is defined, with, say three firms, the next question is: Is it possible for a hypothetical monopolist (comprised of these three firms) producing product A and its close substitutes to raise the price 5% or more for a year and not lose profits? If the answer is yes, then we have found the relevant market because it means there are no other substitutes for consumers to go to. If the answer is no, this means customers can go to other firms to buy products that satisfy what product A offered. The next step would be to include more close substitutes. The same question is asked, is it profitable for a hypothetical monopolist comprised of the firms that produce this group of products to raise the prices 5% or more over a year? These steps are repeated until we reach the point where the hypothetical monopolist can no longer raise its price without losing enough customers to make the price increase unprofitable. The sales divisions of companies sometimes will have information that can be used for such a test. The sales divisions often keep track of where they win customers and lose customers (to whom is business lost? From whom is business gained?) Another source of information may be in the form of customer surveys about your products: if they can't buy your product, what would they buy? The SSNIP test is often said to have shortcomings because it focuses on price. In China, price is a major focus, therefore one should not underestimate the reliance by the Chinese on this test. The guidelines list factors to consider when defining the product and geographic markets.[15] MOFCOM will generally use information from the notification form and in most cases accepts the parties' description of the relevant market.[16]

[2] Potential Harm

[a] Unilateral Effect

MOFCOM, similar to other jurisdictions, recognizes various types of potential harm to competition depending on the structure of the merger. Mergers between competitors,

14. *Id.* at Art. 10.
15. *Id.* at Arts. 8–9.
16. In the notification form question 7.2 asks for the definition of the relevant product market and in the footnotes to the notification form reference is made to using the substitutability analysis for demand and supply. Question 7.3 asks for market share information, the accompanying footnote to the notification form explains the factors for calculation and usage of HHI method.

often referred to as "horizontal mergers" can result in a situation where it is easier for the merged entity to dominate the market, *on its own,* for example, by raising prices, offering fewer choices and reducing the quality of products.[17] This is often referred to as a "unilateral" effect.

For example, MOFCOM challenged the merger of two pharmaceutical companies, Pfizer and Wyeth, because in the swine mycoplasma pneumonia vaccine market the merged entity would have 49.4% of the market (the next largest competitor had 18.35%) and MOFCOM decided that by virtue of the large market share the merged entity could control prices. MOFCOM approved the merger on the condition that the merged entity divest an animal health product business and give the purchaser the technology and help the purchaser get the raw material to manufacture the swine mycoplasma pneumonia vaccine.

[b] Coordinated Effect

Horizontal mergers can also create a situation where, because there are fewer competitors, the remaining firms would be able to more easily coordinate their prices, output, capacity, or other business activities and thus have less competition.[18] This is often referred to as "coordinated" effect.

For example, MOFCOM challenged the two mergers between producers of hard disk products, Seagate/ Samsung and Western Digital/Hitachi. The global and China market have the same five market players, among them Seagate had 33% market share and Samsung 10% while Western Digital had 29% and Hitachi 18%. In both mergers, MOFCOM raised the concern that the merger would increase the likelihood that the after the merger, there would be fewer competing producers of hard disks, making it easier to predict and coordinate what they are doing resulting in less competition among them to keep prices down. MOFCOM approved the mergers on the condition that the parties maintain the competitive status quo for the hard disk products for a prescribed amount of time after which the parties could request reconsideration. The prescribed amount of time was one year in the Seagate/Samsung merger and two years in the Western Digital/Hitachi merger.

[c] Limiting Access

Mergers involving firms that are in a buyer-seller relationship, for example, a manufacturer merges with a supplier of a raw material, or a manufacturer merges with a distributor, are often referred to as "vertical" mergers. Vertical mergers can result in

17. *See* interim assessment provisions Art. 4: first sentence, "When assessing the possibility of negative impact on competition caused by a concentration of firms, the initial factor to be considered is whether the concentration would generate or reinforce a single firm's ability, motive or possibility to eliminate or restrict competition by itself."
18. *Id.* at Art. 4: second sentence, "Where the relevant market is controlled by a small number of firms, it shall also be considered whether the concentration would generate or reinforce the relevant firms' ability, motive or possibility to eliminate or restrict competition jointly."

cost-savings through coordinated manufacturing or distribution. However, sometimes vertical mergers can make it difficult for other firms to enter the market by limiting access to the supplier's market (in a manufacturer/supplier merger) or to the distributor's outlets (in a manufacturer/distributor merger).[19]

For example, MOFCOM challenged the merger between GM, an automobile original equipment manufacturer (OEM) and Delphi, an automobile parts supplier. Delphi is an exclusive supplier to many Chinese OEMs. MOFCOM raised the concern, among others, that the merger could limit access to supplies of auto parts for the Chinese OEMs because they would have trouble switching to other suppliers. MOFCOM approved the merger on the conditions that Delphi continues to supply Chinese OEMs without discrimination or unreasonable conditions, Delphi assists Chinese OEMs switching to other suppliers and GM must continue the policy of multiple sourcing and non-discriminatory purchasing of auto parts.

[3] Factors to Consider When Assessing Potential Impact of a Merger

The AML and Interim Provisions indicate what will be considered when assessing the merger's potential impact on the relevant market, focusing on the merging parties' market share.[20] Additional factors that MOFCOM will consider are: degree of concentration in the relevant market, substitutability of the products, the production capabilities of other companies, how much control the parties will have over the sales market or the procurement market for raw material, the financial strength and technical capabilities of the parties to the transaction, the merger's impact on entry into the relevant market and on technological progress, the merger's impact on consumers (e.g., can the customers of the merging parties switch to suppliers who are not the merging parties? What is the purchasing power of the downstream customers?) and, finally, the merger's impact on national economic development.[21] Although the AML does not make any presumptions that certain levels of market share will mean that the merger will be blocked, MOFCOM has emphasized market shares and market concentration levels as primary grounds for finding potential antitrust issues.[22] Conversely, low market shares such as 6.8% to 17.8%[23] and 16.1%–18.7%[24] are no guarantee of merger approval.

19. *Id.* at Art. 4: third sentence, "Where the firms participating in a concentration are not actual or potential competitors in the same relevant market, the review shall focus on whether the concentration will have or likely to have the effect of eliminating or restricting competition in the upstream and downstream markets or associated markets."
20. *Id.* at Art. 5.
21. *See* AML Art. 27 and interim assessment provisions Art. 5.
22. In the two blocked mergers: Coca Cola/Huiyuan (MOFCOM merely stated that Coca Cola had a dominant market position without stating the specific shares) and P3 shipping alliance (46%). In the conditional approvals, the following are examples of the market shares that raised concern: 100% (Penelope/Savio), 64% (Mitsubishi/Lucite), 49.4% (Pfizer/Wyeth), market shares of various equipment ranged from 59%–64% (Baxtor/Gambro).
23. Glencore/Xstrata.
24. Marubeni/Gavilon.

[C] Tools for Analysis

[1] Herfindahl-Hirschman-Index

MOFCOM relies on tools just like other nations' antitrust agencies. Simply put, most of the tools are based on the general principle that the more competitors there are in the market, the more competitive it is, prices are lower and there is more innovation. Generally, the more competitors, the better off the consumers are. Using such tools can be tricky. On the one hand they are a way to analyze and predict behavior. On the other hand, because the outcome depends on the integrity of the underlying data, these tools are not 100% fail-safe. Similar to other jurisdictions, MOFCOM uses the Herfindahl-Hirschman-Index (HHI), a mathematical formula for measuring pre-and-post transaction market concentration.[25] The HHI is calculated by taking the sum of the squares of the market share of each of the firms competing in a market (e.g., where there are five equal-sized firms, the calculation is, 20 squared plus 20 squared plus 20 squared plus 20 squared plus 20 squared is 2,000) and 10,000 is the perfect monopoly where there is a single firm (100 squared is 10,000). In the Chinese antitrust regime there is no standard regarding what number indicates a concentrated industry the way the U.S. and the EU do in their guidelines for horizontal mergers.[26] The U.S. standard is that an unconcentrated market has an HHI that is below 1,500, moderately concentrated markets have HHI between 1,500 and 2,500 and highly concentrated markets have HHI above 2,500.[27] The EU standard is that markets with post-merger HHI of less than 1,000 normally will not require analysis.[28] MOFCOM also uses the Concentration Ratio (CRn) to measure the degree of concentration within a market where "n" refers to the number of largest firms in the relevant market. The CR is the percentage that this group occupies in the market.[29]

[2] Margin-HHI Regression

MOFCOM has also started to use additional economic analysis to predict future pricing of the post-transaction entity. These include the margin-HHI regression and the "Illustrative Price Rise" test.[30]

25. In the merger notification form, question 7.3 asks for market share information, the accompanying footnote explains the factors for calculation and usage of the HHI method.
26. In the Interim assessment provisions, Art. 6 merely states: "Generally, the higher the concentration of the relevant market is, and the greater the increment of the market concentration will be after the merger, the more likely the concentration will have the effect of eliminating or restricting competition."
27. DOJ/FTC Horizontal Merger Guidelines of 2010 [hereinafter "DOJ/FTC Horizontal Merger Guidelines"], *see* the Web site of DOJ, available at *http://www.justice.gov/atr/public/guidelines/hmg-2010.html.* p. 19.
28. *Id.* at paras. 19–20. The guidelines also state "The Commission also is unlikely to identify horizontal competition concerns in a merger with a post-merger HHI between 1000 and 2000 and a delta below 250, or a merger with a post-merger HHI above 2000 and a delta below 150," and then lists exceptional circumstances.
29. Interim assessment provisions, Art. 6.
30. I thank Dr. Su Sun for helpful discussions on these analytical methods.

If you pursue your right to injunctive relief related to an alleged infringement of your patent, will this be seen as an abuse of your IPR under the AML?

The starting point is to review the overall Chinese policy towards the particular industry or product in which the foreign patent-holder is involved. The biggest challenge is that the Chinese antitrust enforcers tend to slip into the role of regulators supporting China's industrial policy as opposed to enforcers of competition policy.[64] Any negotiations with enforcers should reflect acknowledgement of China's policies yet at the same time emphasize that China's growth should not come at the expense of healthy and fair competition.

64. EXAMPLES: (a) in the Google/Motorola conditional approval MOFCOM turned conduct that the parties were already engaging in into conditions: MOFCOM wanted Google to continue to offer Android free of charge and Motorola must continue to adhere to its FRAND commitments, (b)in the Microsoft/Nokia conditional approval, MOFCOM turned certain FRAND conduct (that Microsoft already voluntarily agreed to abide by such as not pursuing injunctions against alleged infringers) into conditions for approval. These are just a few examples of how MOFCOM was stepping into a regulatory role.

CHAPTER 8

Abuse of Administrative Power

§8.01 BACKGROUND

As discussed in the introduction, although China is politically a centralized state, economically it is decentralized. The local governments' desire to protect their own economies and local companies, who pay taxes locally, has always been seen as a major hurdle to the economic development of China. The Anti-Monopoly Law (AML)[1] prohibits government administrative organs from misusing their official positions to restrict or eliminate competition. Specifically, local government entities are prohibited from forcing companies or individuals to deal exclusively with companies designated by the government entity,[2] blocking inter-regional trade,[3] preferring local bidders to external bidders,[4] preferring local investors,[5] forcing companies to engage in

1. Anti-Monopoly Law of the People's Republic of China (adopted at the 29th Sess. of the Standing Comm. of the 10th National People's Congress on August 30, 2007, effective August 1, 2008). [hereinafter "AML"].
2. *Id.* at Art. 32.
3. *Id.* at Art. 33: prohibiting measures such as: (i) setting discriminatory charges, implementing discriminatory rates, or fixing discriminating prices for non-local goods; (ii) restricting the entry of non-local goods into the local market through the imposition of technical requirements or inspection standards that are different for non-local goods as opposed to local goods or through the imposition of discriminatory technical measures such as repeated inspections or repeated certifications of non-local goods; (iii) restricting the entry of non-local goods into the local market through administrative licensing programs aimed at non-local goods; (iv) blocking either the entry of non-local goods or the exit of local goods by setting up barriers or adopting other means to achieve such a result; and (v) other activities that may block inter-regional free trade of goods.
4. *Id.* at Art. 34: prohibiting government entities from rejecting or restricting non-local companies from participating in local tenders and bids through such measures as imposing discriminatory qualification requirements or assessment standards or failing to publicize the "binding" information that is required by law.
5. *Id.* at Art. 35: prohibiting government entities from treating non-local companies and local companies on an unequal basis by rejecting or restricting either: (i) investment in the local jurisdiction by non-local companies; or (ii) the setting up of branch offices in the local jurisdiction by non-local companies.

anticompetitive conduct that is forbidden by the AML (such as joint boycotts of a supplier or manufacturer),[6] and from passing provisions that would eliminate or restrict competition.[7] On its face, this prohibition is directed at local administrative entities and is similar to the topic of state action, which, in the United States, is covered by the Commerce Clause of the U.S. Constitution and in the EU by the Treaty of Rome.[8]

§8.02 NOT ONLY GOVERNMENT ACTION BUT ANTICOMPETITIVE CONDUCT OF COMPANIES

Tucked away in rules issued by State Administration of Industry and Commerce (SAIC), the agency responsible for enforcing the AML with regard to non-price related anticompetitive conduct, is a provision relevant to companies. This provision prohibits companies from concluding and implementing anticompetitive agreements or, if they have a dominant market position, abusing this position by means of government actions such as government restrictions, authorizations or legislation.[9] This is conceptually the same as the U.S. concept of "no state action defense." Under the SAIC Abuse of Administrative Power Rules, being authorized by an administrative organ is not a defense for a company to engage in anticompetitive conduct. Also, although it is not explicitly stated in the law or regulations, it could be argued that it is a violation for a company to request an administrative organ to issue a law or regulation that would prevent other companies from competing with it. For example, if a company lobbies for a regulation that sets the standards for the technology required for a certain public works project and it turns out that this company is the only one that is able to meet the standard, the company could potentially be in violation of the AML.

§8.03 ENFORCEMENT THROUGH ADMINISTRATIVE DECISIONS OR JUDICIAL DECISIONS

Abuse of administrative power complaints can be either filed with one of the antitrust enforcement agencies for an administrative decision or filed in court for a judicial decision. There have not been many cases, either administrative or judicial, but the government is trying to show its commitment to pursuing administrative abuses of power. MOFCOM has sent out a questionnaire to companies asking if they have experienced discriminatory treatment or other forms of administrative abuse.[10]

6. *Id.* at Art. 36.
7. *Id.* at Art. 37.
8. Eleanor M. Fox, *An Anti-Monopoly Law for China-Scaling the Walls of Government*, ANTITRUST LAW J. No. 1 (2008), *see* discussion on anticompetitive state restraints in the United States and European Union, pp. 181–188.
9. Rules Regarding the Prohibition of Abuses of Administrative Power that are Anticompetitive, State Administration for Industry and Commerce, issued December 31, 2010, effective February 1, 2011 [hereinafter "SAIC Abuse of Administrative Power Rules"], Art. 5.
10. "Notice on Carrying out an Investigation Questionnaire against Regional Blockades and Industry Monopolies to the China Automobile Dealers Association" May 2014. The purpose is to solicit comments and appeals from the association and its member companies on topics such as: (i) discriminatory charges, discriminatory charge rates or discriminatory prices for non-local enterprises, (ii) whether non-local enterprises confronted abuse of the administrative power by local government that has hindered and restricted non-local enterprises' entry into local product or service market and (iii) whether companies have seen any local government or department documents indicating regional blockades or industry monopolies. *See* MOFCOM official website, available at www.mofcom.gov.cn.

[A] *Administrative*

There has only been one published administrative decision regarding a foreign company.[11] A Chinese-Korean joint venture complained to the South Korean Embassy that it was being charged higher bridge and road tolls than local transport companies. The South Korean Embassy contacted the National Development and Reform Commission (NDRC) which in turn issued a letter called "Suggestions on Law Enforcement" to the local government, suggesting that the local government cease charging non-local transport companies unfair bridge and road tolls. This type of a letter, a "suggestion," is in accordance with AML Article 51 which states that the antitrust enforcement agency may offer suggestions to the relevant government authority on how to handle the alleged abuse of administrative power.

[B] *Judicial*

To date, there has only been one court case that has been adjudicated (another court case was dismissed). A software company filed a lawsuit against the provincial department of education because participants in a competition organized by the provincial department of education were forced to use software designed by a local company. The software company claimed that it suffered loss of business in the short term and in the long term the company whose software was preferred would become the sole dominant company in the market. The court concluded that the department of education failed to prove the legality of its procedure for selecting the software provider and therefore abused its administrative power.[12]

11. This case is not published on NDRC website. The former director of the NDRC's antimonopoly bureau, Mr. XU Kunlin, reported this case on a meeting held by the State Council. Xinhua News Agency published a news report about this report in Chinese. http://news.xinhuanet.com/yuqing/2014-09/13/c_126982078.htm. The "Suggestion on Law Enforcement" was sent to the Hebei Provincial People's Government. There was another case where the local office of the State Administration for Industry and Commerce (SAIC) suggested to the local government that the local municipal government must cease favoring local suppliers (this matter was based on a petition filed with the local SAIC office by three manufacturers of GPS systems for cars). *See* official SAIC website http://www.saic.gov.cn/. SAIC disclosed that one of the three manufacturers, Easy Flow Technology Co., Ltd, filed a petition with the Guangdong Provincial AIC that a local city government (SAIC did not specify which city it is) favored one local GPS supplier, New Space-time GPS Technology Co., Ltd.
12. The written judgment of this case is not available currently, however, a news report published by China Court official website outlines the decision and procedure of this case. *See* http://www.chinacourt.org/article/detail/2015/02/id/1556601.shtml. The parties to this case were Shenzhen Sware Technology Co., Ltd (plaintiff), Department of Education of Guangdong Province (defendant) and Glodon Software Company Limited (third party).

§8.04 PUTTING THINGS IN PERSPECTIVE

Companies have been reluctant to confront the local government for fear of retaliation. To date there have not been many reported cases, but generally, misconduct by the Chinese government, both in terms of anti-corruption as well as regional protectionism, has become a major focus of attention in China. This focus on the abuse of administrative power is potentially a tool for non-local companies (foreign companies as well as domestic companies that are not from the particular region) if they are being blocked from local projects or treated in a discriminatory way. Thus the AML may be a useful tool if you are suffering discrimination, or, of course, a risk if you are doing the discriminating.

APPENDIX I

Anti-monopoly Law of the People's Republic of China [Effective]

中华人民共和国反垄断法［现行有效］

Issuing authority:	Standing Committee of the National People's Congress	**Document Number:**	Order of the President of the People's Republic of China(No.68)
Date issued:	08-30-2007	**Level of Authority:**	Laws
Area of law:	Anti-Unfair Competition		

Order of the President of the People's Republic of China

(No.68)

The Anti-Monopoly Law of the People's Republic of China, which was adopted at the 29th meeting of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on August 30, 2007, is hereby promulgated, and shall be effective as of August 1, 2008.

President of the People's Republic of China: Hu Jintao

August 30, 2007

Anti-Monopoly Law of the People's Republic of China

(Adopted at the 29th meeting of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on August 30, 2007)

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