

China's New Anti-Monopoly Law: *Let The Games Begin*

The first of three webinars designed to help clients understand & comply with the new law

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Agenda

- Background to the Anti-Monopoly Law (AML)
- Key Prohibitions and Compliance Tips
- Expected Areas of Regulatory Focus
- Hong Kong Update
- Questions?

Background to the AML - Antitrust in China Pre-AML

- The AML is China's first comprehensive competition law
- Previously, provisions scattered through various laws & regulations:

Pricing Law 1997 (price fixing)	Anti-Unfair Competition Law (unfair bundling)
Tender Invitation and Bid Law (bid rigging)	Provisions on Preventing Act of Price Monopoly (monopolistic pricing)
Regulations Prohibiting Anti-Competitive Practices of Public Enterprises	M&A Regulations (merger control)

- Administered by Ministry of Commerce (MOFCOM), State Administration of Industry & Commerce (SAIC), and National Development & Reform Commission (NDRC) - Plus regional/municipal bodies
- Lack of will to tackle many manifest anti-competitive practices
- **Result:** Undeveloped regime, lack of coherent policy

Background to the AML - Drafting and Development

- Drafting commenced in 1994; sporadic progress thereafter
- Some momentum after WTO accession in 2001
- Debates focused less on wording technicalities, and more on fundamental policy issues

Regulatory treatment of SOEs?

How would merger control operate?

Division of antitrust enforcement responsibilities?

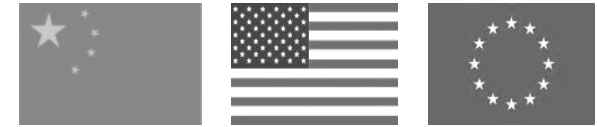
How would administrative monopolies be regulated?

- AML promulgated August 30 2007, commenced August 1 2008
- A framework for more consistent and rigorous regulatory action, but seems many key debates are ongoing - thus a "soft launch"

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Key Prohibitions - Comparison to US & EU Regimes



• Monopoly agreements (Cartel practices, vertical restraints)	✓	✓	✓
• Abuse of dominance	✓	✓	✓
• Prohibited concentrations (merger control)	✓	✓	✓
• Laws re administrative monopoly	✓	✗	✗

But AML has distinct China characteristics, including purpose of "promoting healthy development of socialist market economy"

Key Prohibitions - Monopoly Agreements (Horizontal)

Article 13 prohibits agreements, decisions or other concerted practices between competitors that eliminate or restrict competition, viz., agreements to:

- Fix or change prices of products
- Limit the output or sales of products
- Allocate the sales markets or the raw material purchasing markets
- Limit the purchase of new technologies or new facilities, or limit the development of new products or new technologies
- Jointly boycott transactions or
- Other monopoly agreement practices determined by the Anti-Monopoly Enforcement Authority

Key Prohibitions - Monopoly Agreements (Vertical)

Article 14 also prohibits agreements, decisions or other concerted practices between trading partners to:

- Fix the resale prices of products to third persons
- Limit the lowest resale price of products to third persons
- Other monopoly agreement practices determined by the AMEA



Unresolved questions

- “De minimus” threshold? Minor restrictions actionable?
- How will **intra-group transactions** be treated (i.e. between parent company & wholly-owned sub? Note concentration exemption)
- Scope of **exemptions**? (PTO)

Key Prohibitions - Monopoly Agreement Exemptions

Article 15: Exemptions to monopoly agreement prohibitions apply if an agreement aims to achieve certain beneficial impacts, including

- 1) Technology improvement or research and development of new products
- 2) Upgrading of product quality, cost reduction, efficiency improvement, the unification of product specifications and standards, or the realization of division of work based upon specialization
- 3) The improvement of operational efficiency and the enhancement of small and medium-sized undertakings
- 4) The serving of public welfare such as energy conservation, environmental protection, and the provision of disaster relief

Key Prohibitions - Monopoly Agreement Exemptions

- 5) The mitigation of **economic recession** such as alleviating severe decreases in sales volume or excessive overstocking
- 6) The safeguarding of **legitimate interests** in foreign trade and economic cooperation
- 7) Other circumstances specified by laws and China's State Council

BUT...

Concluded monopoly agreements must not substantially restrict competition in the relevant market, and consumers must be able to share in the benefits derived from the agreement - EXCEPT item (6)

Key Prohibitions - Monopoly Agreements: Compliance

- Conduct standards expected to be similar to EC and US, except for the highlighted “unique” China provisions
- Primary focus of regulators in the coming months is likely to be on “hardcore” cartel conduct, trade associations
- Identify distribution and resale arrangements in China, and ensure pricing terms ok. Document “exemption” reasons
- “Red flags” from investigations in more mature antitrust jurisdictions? (Microsoft example)
- Keep up to date with new implementation rules and guidelines
- Be aware of the risk of private actions

Key Prohibitions - Abuse of Dominance: Assess Position

- Chapter 3 prohibits certain conduct by undertakings that occupy a dominant market position.
- A business (x) is deemed dominant if its market share is
 - $\geq 50\%$
 - together with 1 other company, $\geq 66\%$ or
 - together with 2 other company, $\geq 75\%$

{ where the market share of X $\geq 10\%$
- Otherwise assessed on ability to control trading conditions or restrict market entry. Considerations include:
 - Market share and financial strength
 - Overall levels of market competition
 - Control over supply / demand for inputs / outputs
 - Barriers to market entry
 - Relationships which strengthen market position

Key Prohibitions - Abuse of Dominance: Abuse Conduct

- The following conduct is considered "abuse" of dominance:
 - Selling products at unfairly high prices or purchasing products at unfairly low prices
 - Without valid reasons:
 - Engaging in below cost selling
 - Refusing to trade with trading partners
 - Restricting the trading activity of trading partners
 - Tying products or imposing unreasonable trading conditions
 - Applying differentiated treatment with regard to trading conditions (such as trading prices) to equivalent trading partners

Key Prohibitions - Abuse of Dominance: Compliance

- Likely to be an enforcement priority for the regulators
- Assess whether your business may be dominant, considering “official statistics” and IP positions
- Practices that may be subject to particular scrutiny:
 - selling "tied" products and services;
 - imposing unequal terms between trading partners;
 - the terms of IP licensing
 - unfair high pricing / compulsory licensing risk

Key Prohibitions - Administrative Monopoly

- Concerns restraints of trade by regional, provincial or local governments to pursue protectionist or parochial objectives

Examples:

- Blocking market entry
- Discriminatory taxes / license fees
- Discriminatory highway weight limits
- Local purchase requirements
- Over-inspection

- Widely regarded as a serious competition problem in China. Some high profile instances
- Article 8: "Administrative agencies and organizations... shall not abuse their administrative power to eliminate or restrict competition". Various practices then referenced
- But enforcement left in the hands of the local officials and their regional and provincial superiors

Key Prohibitions - New Merger Control Provisions

- New AML provisions effectively replace the existing regime dealing with M&A activity in or impacting China
 - *Regulations Governing the Merger with and Acquisition of Domestic Enterprises by Foreign Investors (M&A Regulations)*
- The AML extends merger control to M&A between domestic China entities that are not foreign-invested

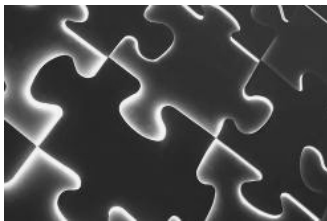


Key Prohibitions - Merger Control Prohibition



What is prohibited?

Participation in a "concentration" that has the effect or likely effect of eliminating or restricting competition



A "concentration" is

- Merger activity
- Acquisition of "control"* over other companies through the purchase of shares or assets or
- Acquiring "control"* or the capability of imposing "determinative effects"* on other companies by virtue of contractual rights or other means

(* Not defined)

Key Prohibitions - Merger Control Notifications

Pre-merger notification requirement

	Global turnover	China turnover
1	All parties* combined: RMB10b (US\$1.46b)	At least 2 parties* each: RMB 400m (US\$58.6m)
2		All parties* combined: RMB 2b (US\$293m) plus at least 2 parties each: RMB 400m (US\$58.6m)

- Based on historical MOFCOM approach, calculation of **turnover** should include turnover of broader corporate group. This may be refined over time, to only include companies in control of, or controlled by, the transaction parties.
- **Exemption** possible for certain intra-group transactions



Key Prohibitions - Merger Control Timing

Notification timing

- Not specified yet - existing timing requirements under the M&A Regulations should continue (notify by later date of [i] public announcement of transaction, or [ii] filing in home jurisdiction)

Review timing

- A transaction subject to review may not be completed before it is formally cleared, or the relevant waiting period expires.
- Waiting periods (up to 180 days): All filings subject to initial **30-day** review period (from filing date). If no decision, or decision that no further review will be conducted, transaction free to close
- Alternatively, MOFCOM can advise that transaction is subject to an additional **90 day** investigation (extendable by **60 days** under certain circumstances)



Key Prohibitions - National Security Review

National security review

- Required before foreign companies permitted to purchase / invest in China operations if transaction could affect “national security” (not defined)

Broadening existing review regime?

- Foreign investors currently require approval if purchase of a PRC company likely to
 - Affect “national economic security”
 - Takes place in key sectors or
 - Transfer operating rights of famous domestic brands

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Expected Areas of Regulatory Focus - The "Sell" Phase

The AML has been sold domestically as a law to tackle

- "Unfairly high prices"

Targets: Trade associations, dominant IP holders and licensors

- "The multinational invasion"

Targets: Big multinationals, dominant IP holders and licensors

These are not nearly the most serious competition problems facing China, but they galvanize support for the law.

This has increased the anxiety that foreign businesses, and in particular foreign dominant IP holders, will be key regulatory targets under the law

Expected Areas of Regulatory Focus - Multinationals

Ties in to a broader concern -

Will the AML be applied discriminately against foreign companies?

YES	NO
<ul style="list-style-type: none">• 04&05 SAIC and MOFTEC reports: multinationals unfairly dominating markets• Objectives of AML include "promote ... socialist market economy"• Exception to monopoly agreement prohibition for "safeguarding legitimate interests in foreign trade and economic cooperation"• "National security" and "National economic security" review for acquisitions of domestic companies• Interest in promoting national champions• Exemption of SOEs from the law	<ul style="list-style-type: none">• Broad antitrust laws are standard - the devil is not always in the detail• China is not alone in deviating from "pure" competition models• Much emphasis on adopting European standards• "The longest journey begins with a single step".

Expected Areas of Regulatory Focus - IPRs

- Specialised IP courts responsible for hearing cases brought under the AML - reflecting that IP is likely to be a significant focus of many AML cases
- To what extent will China adopt accepted antitrust approaches to IP issues? Article 55 not entirely clear, but looks positive
- History of IPR protection in China not long - Yet to implement specific competition guidelines re IPR & standards setting, etc.
- Status of patent pools, standard setting, etc?
- Compulsory licensing probably the key initial issue.
- Microsoft "test case" will be very significant

Expected Areas of Regulatory Focus - SOEs

- BUT - SOEs the primary concern for many domestic businesses, and they may be largely exempt from the law
- Article 7
 - "The State" shall "protect their legitimate business activities"
- SOEs dominant in key sectors
 - Petroleum, natural gas, telecoms, electricity, coal, civil aviation, waterway transport, and national defence
- Perception that SOEs are often inefficient & reliant on anti-competitive practices to maintain significant market share or monopoly positions
- AML enforcement to be left in the hands of existing sectoral regulators?



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Hong Kong Update - Background to Current Situation

May 98

COMPAG *Statement on Competition Policy* released, outlining various forms of anti-competitive conduct and expressly contemplating action against those in breach of the policy - but no force of law, thus "toothless"

2000

Sector-specific competition provisions introduced into Telecommunications Ordinance and Broadcasting Ordinance

Jun 05

CPRC appointed to make recommendations on competition policy. Publishes report in June 06, recommending adoption of cross-sector law encompassing two of three "essential pillars" of competition law

Nov 06

"20 key questions" public discussion document and consultation

Aug 07

Period of informal consultation with select industries and experts

Nov 07

Chief Executive commits to introducing a competition bill in LegCo in the 2008/2009 legislative session

May 08

Consultation Paper incorporating detailed proposals

August 08

End of 3 month consultation period, with publication of consultation report and release of a "white paper" next key developments

Hong Kong Update - New Insights

From our discussions with the Hong Kong government we expect:

- **Merger control**

Provisions may be included in the law, but no specified commencement date (subsequent legislative enactment needed to commence these)

- **Conduct rules - "Grace period"**

Likely there will be a one / two year "grace period" after introduction, before the conduct rules and penalties become effective. This period will be used for development of guidelines, and to allow businesses to prepare for compliance

- **Sectoral exemptions**

Industry exemptions likely only for utilities. Conduct clearance avenues may be limited by low funding of CC

- **Application of European precedents**

In the absence of Hong Kong antitrust precedent outside of telecommunications and broadcasting, EC decisions likely to provide useful guidance

China & Hong Kong Antitrust - How JSM Can Assist

Mayer Brown JSM can provide:

- Merger filing expertise
- Comprehensive business reviews
- Solutions and workarounds
- Tailored training programs
- Legal updates & newsletters
- The benefit of local expertise & multi-jurisdiction experience



Dedicated Anti-Monopoly Law resource page:
www.mayerbrown.com/chinaantimonopolylaw

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