MAYER • BROWN
JSM

Legal Update
Antitrust & Competition
Mainland China
14 November 2011

China Antitrust Moves Up a Gear

The third anniversary of the commencement of China's Anti-Monopoly Law ("**AML**") passed in August of this year without significant attention from the international community. This is not surprising, as until recently 2011 had been a relatively quiet year in terms of AML enforcement. Indeed, until very recently there had been just one 'adverse' merger control decision in 2011, a continued absence of successful private actions relating to the law, and little evidence of significant investigations by the key Chinese competition authorities beyond cartels in certain politically sensitive sectors. In this context, it seemed to many observers that 2011 was not going to be the year that the long-anticipated acceleration in AML enforcement would finally occur.

Just a few months later, that appears to be changing - and quickly. The Anti-Monopoly Bureau of China's Ministry of Commerce ("**Mofcom**") has now handed down two conditional merger control decisions in two weeks, with the latest decision on 10 November concerning a proposed joint venture involving multinational conglomerate G.E. Meanwhile, the Price Supervision and Anti-Monopoly Bureau of the National Development and Reform Commission ("**NDRC**"), which is charged with enforcing key prohibitions in the AML in the context of price-related conduct, has today announced the imposition of large fines on two Chinese companies in China's pharmaceuticals sector, for AML-related infringements. And perhaps most significantly of all, the NDRC has now announced that it is investigating two of China's largest state-owned enterprises, China Telecom Corporation Limited ("**China Telecom**") and China United Network Communications Corporation Limited ("**China Unicom**"), for alleged abuse of a dominant market position.

In this legal update we examine these latest developments, and consider their implications in terms of the short and long term future of AML enforcement.

The NDRC's investigation of two prominent China SOEs

The announcement of the NDRC's investigation into China Telecom and China Unicom was made on 9 November by Li Qing, deputy director of the relevant bureau within the NDRC. Although the NDRC has only chosen to make public certain details of the investigation now, it is understood to have been looking into the matter since the first half of the year.

According to the announcement by Li Qing, the NDRC considers China Telecom and China Unicom together hold a dominant position a relevant broadband related market in China. Further, the NDRC believes the SOEs may have engaged in unlawful 'price discrimination' in certain domestic trading relationships. Although full details remain unclear, it is understood that the specific trading relationships at issue are those between the SOEs and certain broadband suppliers in China who lease access to the broadband network operated by the SOEs and resell that access to consumers - in competition with the SOEs or affiliate companies (who thus are present in both the 'upstream' and 'downstream' markets).

The implication is thus that the SOEs gave less favourable access prices to the broadband suppliers who were most strongly competing with them in the downstream market. This type of price discrimination conduct is often said to involve a 'price squeeze', as there may be very little (or no) room for the relevant downstream broadband suppliers to make a profit margin when you take into account the price paid for access and the price that

needs to be charged to broadband customers to be competitive in the downstream market - and thus those suppliers are at risk of being 'squeezed' out of that market.

PRICE DISCRIMINATION UNDER THE AML

Price discrimination by a dominant business operator is expressly prohibited by Article 17 of the AML. Readers familiar with the competition laws of other mature regimes such as the E.U. and the U.S. will know that the practice is also prohibited in those regimes in relevant circumstances - and that it has not been uncommon for price discrimination cases to arise in their telecommunications-related sectors.

However, it is interesting to note that, in contrast to the situation in the E.U. and U.S., there is very little formal guidance in China to indicate how a price discrimination case will be assessed.

Article 16 of the NDRC *Provisions on Anti-Price Monopoly*, which usefully supplements a number of other broad provisions in the AML, largely just rephrases the relevant AML prohibition. Specifically, it states that dominant business operators "shall not, without a justifiable reason, apply differentiated treatment with respect to trading prices to equivalent trading partners". Unfortunately, the provisions do not provide any guidance as to the types of reasons for applying differential pricing that may be considered "justifiable", nor explain the circumstances in which two or more transactions with trading partners of a dominant business operator will be considered to be "equivalent".

However, it is worth noting that another key competition authority in China, the State Administration of Industry and Commerce ("**SAIC**") has also published some guidance relating to Article 16 of the AML in its *Rules on Prohibition of Abuse of a Dominance Market Position*. These Rules indicate that in considering whether any differential pricing by the SOE is "justifiable", regard would be had to matters such as:

- whether this was part of their normal operating activity (which may be taken as indicating that an unfavourable view of the price differential may be more likely if it was only recently implemented, say in response to new entry or more competitive pricing in the downstream market); and
- the effect of the relevant conduct on economic efficiency and public interests.

It is also worth noting that an April 2009 draft of the relevant SAIC Rules provided some guidance on when transactions would be deemed to be "equivalent" in the relevant context. Specifically, the Rules stipulated that this would be determined with regard to factors such as whether the transactions:

- concerned the same or similar products, and product quantities;
- involved the same or similar transaction conditions (obviously apart from the pricing at issue in this context); and
- were implemented around the same period, from a timing perspective.

For reasons that remain unclear, this aspect of the draft Rules was omitted when they were finalised.

POTENTIAL PENALTIES

If the NDRC concludes that an infringement of Article 17 has occurred, it may fine each infringing party between 1% and 10% of their previous year's turnover - and may also seek to confiscate any identified "illegal gain" obtained via the infringement conduct. Orders to cease that conduct may also be issued. It is worth noting that action may also be taken under antitrust-related laws in China which pre-date the AML, such as the Price Law (which also prohibits discriminatory pricing).

KEY TAKE-OUTS

The NDRC investigation will be watched closely by both domestic and international observers, including to see what evidence arises regarding the present sophistication of this competition authority in terms of procedural case-handling and substantive analysis.

One major question the case may help to answer is just how closely the Chinese authorities are aligned with other mature competition regulators in their approach to abuse of dominance cases. The SAIC and NDRC guidance mentioned above certainly allows for such alignment, but is too broadly and imprecisely stated to allow for any strong conclusions to be drawn at this point. Accordingly, a specific decision on this case, if published, may be enlightening. However, it must also be noted that as the E.U. and U.S. regimes do not approach price discrimination cases in a wholly consistent manner, and their approach to such cases is continually evolving, it cannot be said that there is a definitive 'best practice' international approach for the Chinese authorities to align with.

Another aspect of the case that is interesting is that it involves prominent SOEs in China.

When the AML was introduced, questions were raised as to whether SOEs would be subject to the AML, or would be afforded special treatment (which appears to be permitted, to some extent, by certain provisions in the law). However, in recent years we have seen a number of AML-related private action cases involving SOEs as defendants. Now, we have China's most high-profile abuse of dominance case to date also concerning SOEs. Accordingly, it seems clear that any special protection that may be afforded to SOEs in China in the context of the AML may be very limited indeed. Of course, as none of the aforementioned private actions have been successful, observers will still closely watch the outcome of this new case for any signs that AML-related decision making is being influenced by the special position of the relevant companies in China's economic and political structure.

More generally, the question must be raised as to whether this case marks the likely beginning of more active enforcement of the so-called 'conduct rules' in the AML (the general prohibition of anti-competitive agreements and the abuse of dominance prohibition), and we will have more to say on this point at the end of this legal update.

The NDRC's new penalty decision

Just five days after announcing the investigation into China Telecom and China Unicom, the NDRC announced that it was imposing significant AML-related fines on two Chinese pharmacy companies - Shandong Weifang Shuntong Medicine Co., Ltd. and Shandong Weifang Huaxin Medicine Trading Co., Ltd.

Full details of the case are still being sourced, but it is understood the infringements of the AML that were identified by the NDRC relate to the companies' exclusive supply arrangements with downstream customers relating to compound reserpine tablets (a kind of anti-high pressure medicine). Observers of the AML regime will be watching closely for full details of the decision, so that a more complete understanding of the relevant anti-competitive as well as the investigation and assessment methodology of the NDRC can be gained.

The fines imposed on the two companies totalled RMB 6.877 million (approx USD 1.07 million) and RMB 152,600 (approximately USD 24,000) respectively. At this stage, it is unclear what portion of this may be 'recovery of illegal gains' rather than just penalty calculated according to a percentage (which may be between 1-10%, at the discretion of the NDRC) of the companies' turnover.

This is not the first fine the NDRC has issued for breaches of competition-related provisions in China; it has been particularly active in recent years in penalising business operators and trade associations involved in cartel-related conduct. However, this is understood to be one of only a few fines issued under the direct authority of the AML, and is certainly the largest such fine to date.

It is pertinent to note that the NDRC was recently reported to have been authorised by the central government to expand the resources of its Price Supervision and Anti-Monopoly Bureau and thus further investigations such as the one that led to the fines above may be expected going forward.

Mofcom's 9th conditional clearance decision

On the day after the NDRC's announcement of its investigation into the China Telecom/China Unicom matter, Mofcom issued its ninth conditional clearance decision. The decision concerns the incorporation of a proposed joint venture ("**Proposed JV**") by GE (China) Co., Ltd. ("**GE China**") and China Shenhua Coal to Liquid and Chemical Co., Ltd. ("**CSCLC**") - a subsidiary of energy company Shenhua Group Corporation Limited.

BACKGROUND - THE PROPOSED JV AND NOTIFICATION TO MOFCOM

The Proposed JV would be active in coal gasification, which involves the transformation of solid coal into a liquid form (referred to as 'coal-water slurry'), and the further re-processing of that liquid into mixed gas such as carbon monoxide and hydrogen. Essentially, this process (hereafter referred to as the "**coal gasification process**") provides a relatively 'clean' and efficient method for utilization of coal for power generation purposes in certain industrial applications.

Specifically, the Proposed JV would, after transfer to it of certain technology relating to the coal gasification process by GE, then on-license the technology (and provide associated engineering services) to third parties.

GE and CSCLC jointly notified Mofcom of their intention to establish the JV on 13 April 2011. The decision by Mofcom thus took almost seven months, although just over a month of this period was taken up by the issue of (and transaction party responses to) requests by Mofcom to supplement the initial notification document in order that it could be deemed comprehensive and complete.

MOFCOM'S FINDINGS ON THE MARKET, POSITION OF THE PARTIES THEREIN, AND EFFECT OF THE PROPOSED ACQUISITION

Although Mofcom recognised that there were various gasification technologies that could be applied to coal, it identified that there was a specific 'coal-water slurry gasification technology licensing market' in China that was impacted by the proposed transaction. According to the decision statement, Mofcom considered that the technology involved in this market differed greatly from other gasification technology - in terms of techniques, requirements on feed coal, feeding mode and other aspects.

Mofcom considered that participation in the market for licensing of this technology is highly concentrated, with only three main competitors (including G.E., who holds the largest market share). Unusually, in comparison to recent decisions, Mofcom did not disclose specific market share levels for these business operators.

MOFCOM also noted that only certain types of coal could be used in the coal gasification process, and Shenhua Group controlled a significant portion of this relevant raw material in China (plus had advantageous transportation assets that provided it with an ability to undercut many of its competitors in this input supply market). Mofcom also ascertained from broad industry and expert consultation that there were high barriers to entry in the relevant market, due in particular to the need for market participants to have access to patented technology and to be in a position to undertake the extensive research and development needed to develop coal gasification for relevant industrial application needs of customers.

In this context, Mofcom was concerned that in combining the input strengths of Shenhua Group with G.E.'s strong position in the coal-water slurry gasification licensing market, the Proposed JV would be in a position to restrict competition in the relevant market.

THE CONDITIONS IMPOSED

Mofcom accepted conditions that were proposed by the parties to address the identified competition concerns, and incorporated these into its approval decision in the form of the following obligations relating to the relevant market:

- the parties shall not force customers to use its technology by restricting the supply of the relevant feed coal, or require customers of the relevant technology to also use the feed coal supply controlled by the parties; and
- the parties should not engage in any conduct that would increase the costs of using other competing technologies.

As is usual for such conditions, Mofcom will have the right to supervise and examine their implementation, and may intervene again if it is not satisfied the conditions are being complied with.

KEY TAKE-OUTS

As is common with Mofcom's published decisions, the level of detail provided to justify its market definition and 'theory of harm' to competition is limited. The decision statement includes little explanation of the reasons why Mofcom considers the coal-water slurry gasification technology utilised by G.E. differs from other gasification technologies and thus constitutes an independent market. Nor does the decision statement contain a great deal of information on the claimed limitations regarding feed coal supplies. This does not in any way indicate that Mofcom's conclusions on these issues are flawed, but rather raises questions about why - after appearing to have devoted considerable time and resources to investigating these issues - Mofcom appears unwilling to publish detailed information to support key findings. For as long as Mofcom continued to publish decisions that are brief and conclusory, it will invite questions about the rigour of its decision marking - which is unfortunate given that most experts in this area believe Mofcom's decision-making methodology and examination of markets is growing increasingly sophisticated.

One key aspect of the decision that will be applauded by international observers is the fact that it concerns a transaction directly involving China companies (CSCLC/Shenhua Group).

This is only the second adverse Mofcom decision directly concerning Chinese companies, with the

other being the decision to block Coca-Cola's proposed acquisition of Huiyuan Juice Group in March 2009. Accordingly, this latest decision will help to rebut any claims that the AML merger control regime is being applied in a discriminatory fashion, and (in combination with the other developments reported in this update) reinforce the fact that it appears state-owned companies are on what is mostly a 'level playing field' with other business operators when it comes to the obligation to comply with the AML.

Concluding comments

The events reported in this update are significant, as they suggest the relevant Chinese authorities are taking AML-enforcement 'up a gear'. In particular, the announcement of the NDRC's imposition of large fines on certain domestic business operators and its investigation of abuse of dominance issues in relation to SOEs serves as a warning that the law is set to have implications for many business operators that go beyond the field of merger review. Those businesses who have been in 'cruise control' when it comes to AML compliance should now heed the amber lights, and take steps to ensure they understand and are complying with China's antitrust 'rules of the road'. Otherwise, it may be a bumpy road ahead.

Contact Us

For inquiries related to this Legal Update, please contact the following persons or your usual contacts with our firm.

Hannah Ha
Partner
T: +852 2843 4378
E: hannah.ha@mayerbrownjsm.com

Gerry O'Brien
Consultant
T: +852 2843 4355
E: gerry.obrien@mayerbrownjsm.com

Nancy Chang
Associate
T: +86 10 6599 9231
E: nancy.chang@mayerbrownjsm.com

Helen Hai
Associate
T: +86 20 8755 1584 x305
E: helen.hai@mayerbrownjsm.com

Mayer Brown JSM is part of Mayer Brown, a global legal services organisation advising clients across the Americas, Asia and Europe. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest banks. We provide legal services in areas such as banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; employment and benefits; environmental; financial services regulatory & enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

OFFICE LOCATIONS
AMERICAS: Charlotte, Chicago, Houston, Los Angeles, New York, Palo Alto, Washington DC
ASIA: Bangkok, Beijing, Guangzhou, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai, Singapore
EUROPE: Berlin, Brussels, Cologne, Frankfurt, London, Paris
TAUIL& CHEQUER ADVOGADOS in association with Mayer Brown LLP: São Paulo, Rio de Janeiro
ALLIANCE LAW FIRM: Spain (Ramón & Cajal)

Please visit www.mayerbrownjsm.com for comprehensive contact information for all Mayer Brown offices.

This publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is intended to provide a general guide to the subject matter and is not intended to provide legal advice or a substitute for specific advice concerning individual situations. Readers should seek legal advice before taking any action with respect to the matters discussed herein. Please also read the Mayer Brown JSM legal publications Disclaimer.

Mayer Brown is a global legal services provider comprising legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe – Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown JSM, a Hong Kong partnership and its associated entities in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. "Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.

© 2011. The Mayer Brown Practices. All rights reserved.