

Local Developments and International Trends Relevant to Hong Kong and China

JSM offers guidance on the conduct rules under China's Anti-Monopoly Law

Webinar: Conduct Rules Under China's Anti-Monopoly Law - Throw Out Your Old Rule Book

KEY EVENT INFORMATION

Date & Time

Thursday,
27 August 2009
1:00 p.m. – 2:00 p.m. (HKT, CST)

SPEAKERS



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In recent months, China's competition authorities have begun clarifying how they will enforce the new Anti-Monopoly Law's broad prohibitions on abuse of a dominant market position and agreements that eliminate or restrict competition. These rules are relevant to all businesses with operations, sales or trading partners in China.

Accordingly, JSM is holding a webinar from 1:00 p.m. - 2:00 p.m. (HKT, CST) on Thursday 27 August 2009 to explain the scope of the new conduct rules in detail, and to assist businesses in Asia ensure compliance with the rules. The webinar will have a particular focus on:

- The scope of business activities covered by the rules and the sectors that may face heightened scrutiny;
- China's unique regulatory approach to concepts such as unfair pricing and limitations on the development of new technology;
- The implications of the developing rules for supply and distribution agreements, joint ventures, IP licensing, and other common business arrangements;
- The prospects for private actions, and the challenges defendants will face in relation to such actions; and
- Practical guidance on how businesses should deal with existing arrangements.

All businesses in the region are invited to join the speakers from JSM's Antitrust & Competition Team for the webinar. For further information on registration, refer to the email attaching this newsletter, or contact the speakers directly.

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When is it unlawful to offer a discount or rebate?

Key points:

- Businesses operating in (or selling into) Hong Kong and China need to be aware that the practice of offering discounts and rebates could potentially raise risks under existing and proposed competition laws.
- The experience of mature competition law regimes indicates that discount and rebate schemes implemented by businesses who possess a significant degree of market power can be unlawful, particularly if it is determined that those schemes are 'exclusionary'. In particular, discounts or rebates offered in return for customer loyalty or exclusive trading arrangements may raise significant concerns.
- It will be prudent for all businesses operating in the region to consider whether they may be caught by the specific prohibition applicable to dominant businesses in China and the proposed prohibition regarding abuse of substantial market power in Hong Kong, and if so to obtain legal advice on any discount or rebate schemes they offer.

In difficult economic times, it is common practice for businesses to ask their suppliers for discounts, and for such requests to be granted. Suppliers realise that their long term interests may be served by ensuring the economic viability of downstream trading partners, and consequently may be willing to lower standard supply pricing to maximise the prospect of maintaining their trading channels and to reward customers for their loyalty.

In this context, it may come as a surprise to many businesses in Hong Kong and China to learn that the practice of offering discounts and rebates may soon raise significant risks.

Under the proposed Hong Kong competition law, and China's operative Anti-Monopoly Law (AML), businesses who enjoy significant market power face the risk of large fines and other penalties if their trading terms are deemed likely to restrict competition. Although the practice of offering rebates and discounts is not expressly mentioned amongst the various examples of anti-competitive conduct set out in the AML, and has not been raised in the various proposal documents that the Hong Kong government has published regarding its proposed Competition Ordinance, it seems clear this type of activity will be subject to scrutiny under these laws. Indeed, based on international experience, the anti-competitive implications of discounts and rebates could be one of the hot topics for local businesses in the coming years.

INTERNATIONAL EXPERIENCE - WHEN ARE DISCOUNTS AND REBATES UNLAWFUL?

The influence of Europe's competition regime on the development of competition law and policy in Hong Kong and China has been well documented, and accordingly it is useful to look to the European experience when considering the potential impact of competition law on discount and rebate practices.

Under Article 82 of Europe's primary competition law, the EC Treaty, a business that enjoys a dominant market position is prohibited from engaging in conduct that constitutes an 'abuse' of that position. Article 82 lists various practices that may constitute

an abuse of dominance (such as imposing unfair high pricing) however this list is non-exhaustive. In recent years, the enforcement practices of Europe's competition regulator and decisions of the European courts have confirmed that discount and rebate practices can constitute an unlawful abuse of dominance under Article 82.

Determining when discounts and rebates may be unlawful under Article 82 of the EC Treaty can be a difficult process. There are no prescribed forms of discount or rebate scheme which will constitute a *per se* infringement of the law - instead, the analysis usually turns on whether the scheme may be considered 'exclusionary' (that is, whether the conduct tends to exclude or restrict competition, and is not supported by other valid business justifications).

WHAT TYPES OF DISCOUNTS AND REBATES HAVE BEEN FOUND TO BE EXCLUSIONARY AND UNLAWFUL IN EUROPE?

In Europe and other jurisdictions with broadly analogous prohibitions, the types of schemes that have been found to be exclusionary and unlawful when implemented by a business with a dominant market position include:

- offering loyalty rebates (or up-front payments) to customers in return for long term contractual exclusivity;
- offering discounts conditional on buyers making all or a large proportion of their purchases from the supplier;
- offering discounts in relation to the supply of one product on condition that the purchaser also buy a 'tied' product (which the purchaser may normally have preferred to acquire separately);
- offering discounts that have the effect of reducing the total cost of supplied goods or services to predatory (i.e. below cost) levels; and

- withdrawing discounts for the reason that a customer has bought some or all of his requirements elsewhere.

It should be noted that the conduct referenced above may not be unlawful in all cases. Determining whether a discount or rebate scheme is unlawful requires consideration of all the circumstances of a relevant case, and in certain scenarios the above practices may not fall foul of Article 82 of the EC Treaty. However, it is reasonable to assume that where a dominant business engages in one or more of the above practices across a significant portion of its customer base, or in a targeted manner to reduce the prospect of key customers switching to competitors, it may face significant competition law risks under the EC Treaty.

In certain cases, there may be valid objective justifications for a discount or rebate scheme that otherwise risks being deemed exclusionary and unlawful. In particular, such a scheme may be justified and lawful where it can be shown that the relevant discounts and rebates are provided on the basis of genuine cost-savings (rather than in return, for example, for customer loyalty), or to stimulate demand or facilitate downstream marketing efforts. Additionally, arrangements such as the provision of 'prompt payment' discounts will rarely raise issues, if it can be shown that they may genuinely reduce the supplier's costs.

However, European case law clearly establishes that it is no defence to argue that profits were low or even non-existent under a discount or rebate scheme, or that the discount or rebate was only given pursuant to a customer request.

RECENT CASE EXAMPLE - INTEL

On 13 May 2009, the European Commission announced that it had fined Intel Corporation €1.06 billion for violating Article 82 of the EC Treaty by implementing an anti-competitive discount and rebate scheme.

Intel, which was found to be dominant in a market relating to Central Processing Unit computer chips (CPUs), offered rebates to a number of computer manufacturers who purchased CPUs from Intel - if they met certain conditions. Those conditions included agreeing to purchase all or a large component of their CPU requirements from Intel. The European Commission found that this and other practices of Intel (such as making payments to a major retailer on condition that it only stock computers with Intel CPUs, and making payments to computer manufacturers to delay the launch of products containing competitor CPUs) had the effect of excluding competitors from the relevant CPU market.

Intel has already been fined by competition regulators in South Korea for related practices, and is also facing investigations in the U.S.

HOW THE ISSUE MAY ARISE IN HONG KONG AND CHINA

China's AML contains a prohibition that is broadly analogous to the 'abuse of dominance' prohibition in Article 82 of the EC Treaty. The AML also contains provisions that deem a business to be dominant where it has a market share over 50% (and it is clear that the relevant 'market' will not always cover the whole of China - regional and even very local market geographies may apply for some products).

Businesses with a market share under 50% may also be found to enjoy a dominant position, particularly if there are high barriers to market entry and they are just one of a small number of incumbent market participants.

In Hong Kong, the government's May 2008 *Detailed Proposals for a Competition Law* consultation paper indicated that the Competition Ordinance due to be put before Hong Kong's Legislative Council in 2010 will include a prohibition of the abuse of substantial market power. Although the level of detail the consultation paper provided on this prohibition was

relatively low, it appears it could apply to a broader spectrum of businesses than the otherwise analogous 'dominance' prohibitions in China and Europe.

The regulatory authorities in China are still developing the guidance documents that will explain how the AML's abuse of dominance prohibition will be enforced. However, draft documents published for public consultation indicate that exclusionary conduct will be a significant focus of enforcement efforts. Accordingly, close scrutiny of the discount and rebate practices of dominant firms can be expected, and the same can be expected in Hong Kong when the region's Competition Ordinance comes online.

Accordingly, discount and pricing schemes are likely to face significant scrutiny under the region's competition laws in the years ahead. It will be prudent for all businesses operating in the region to consider whether they may be caught by the specific prohibition applicable to dominant businesses in China and the proposed prohibition regarding abuse of substantial market power in Hong Kong, and if so to obtain legal advice on any discount or rebate schemes they offer.

New competition law enforcement statistics released by China regulator

Key points:

- New statistics relating to enforcement or competition-related laws in China have been released by one of the regulatory bodies charged with enforcing the country's new Anti-Monopoly Law
- Although the figures do not specifically relate to Anti-Monopoly law violations, they demonstrate the significant volume of cases that may arise for review once enforcement of the Anti-Monopoly Law's 'conduct rules' commences.

China's State Administration for Industry and Commerce (SAIC) recently released statistics relating to its enforcement of various competition-related laws during the 1st quarter of 2009. The SAIC is one of three regulatory agencies in China charged with enforcing the new Anti-Monopoly Law ("AML"), and has already built up 15-years experience administering and applying a range of other laws in China that incorporate prohibitions relating to anti-competitive practices.

According to the new statistics, there was a reduction in the volume of SAIC-handled competition law infringements during the 1st quarter of 2009, compared with data for the 1st quarter of 2008. Violations of China's competition laws were identified in a total of 68,202 cases handled by the SAIC in the 1st quarter of 2009, down by 29.98% on the same period in 2008. The competition laws included in these statistics cover not only anti-competitive practices, but also 'unfair trading' and related issues.

Among the 2009 cases, 4,944 related to breaches of China's Anti-unfair Competition Law ("AUCL"). The AUCL was the primary law addressing anti-competitive practices in China prior to the commencement of the AML in August 2008. The conduct identified as being in breach of the AUCL for the relevant 2009 period ranged from competitor collusion in bidding, the forced tying of secondary products to primary product sales, and the imposition of unreasonable trading conditions. 14 of the cases concerned the activities of public enterprises or other businesses that were found to enjoy a monopoly position.

It is understood that all of the released enforcement statistics relate to laws other than the AML, as the SAIC does not appear to have commenced active enforcement of the provisions in the AML in respect of which it has been granted enforcement authority.

However, it seems likely that many of the types of anti-competitive conduct cases currently dealt with under laws like the AUCL will in future be handled under the AML - which will provide the SAIC with far greater investigation and penalty powers.

Private Enforcement of the Future Competition Ordinance in Hong Kong

Key points:

- The Hong Kong government is proposing to include broad private action rights in the forthcoming Hong Kong Competition Ordinance.
- Despite concerns about the effectiveness of this private action regime, it is generally accepted that the regime will add a net benefit to the enforcement of the proposed Ordinance, by making it more accessible and increasing deterrent effect on potential wrongdoers.

Although unified by common purposes, such as enhancing economic efficiency and protecting consumers, competition laws vary significantly from jurisdiction to jurisdiction. This is particularly true in regard to the availability of, and special rules for, private actions.

In the U.S., private actions against undertakings that violate competition laws are not only permitted, they are incentivized by rules that can reward successful litigants with treble damages in such cases. Private actions are also permitted in the mature competition law regimes of the European Union and Australia, while in Singapore such actions can only be brought if there is a prior finding of violation by the country's Competition Commission and relevant appeals processes have been exhausted.

In Hong Kong, the prospects for private actions under the region's proposed Competition Ordinance ("Proposed Competition Law") were laid out in the government's May 2008 consultation paper *Detailed Proposals for a Competition Law*. In this article, we briefly summarise the government's proposals relating to this issue.

"FOLLOW-ON" AND "STAND-ALONE" PRIVATE ACTIONS

The Hong Kong government has proposed that a new Competition Commission be created to lead investigations into suspected or alleged violations of the Proposed Competition Law. However, it is expected the Commission will not have the capacity to investigate all potential cases of anti-competitive conduct. Accordingly, private actions will be available.

According to the government's proposals, parties will be entitled to bring both "follow-on" actions, which seeks remedy in respect of conduct that has been found by the Competition Commission to have infringed the Proposed Competition Law, and "stand-alone" actions, which seeks a determination as to whether or not anti-competitive conduct has been committed. Any private individual or entity who has suffered loss or damage from a breach of the Proposed Competition Law will be entitled to bring an action against the wrongdoer.

HEARING OF PRIVATE ACTIONS

A new Competition Tribunal is proposed to be established, constituted as a special court equipped to hear private actions in this field. The rationale behind the exclusive jurisdiction of this Competition Tribunal is apparently that it will allow for cases to be heard by selected members of the judiciary with the necessary expertise in competition law matters.

For "composite" claims involving non-competition matters, it has been proposed that the region's other courts have the power to transfer only the

competition-related matters to the Competition Tribunal for review and determination.

Subject to the permission of the courts or the Tribunal, it is proposed that the Competition Commission may intervene in any private actions to give its views on the matters. The purpose of such intervention, according to the proposals, is let the Commission provide its expertise on technical matters which may help achieve faster settlement of cases. The Commission may also take an active step in the action by calling evidence in its own right.

REPRESENTATIVE ACTIONS

Under the Hong Kong government's proposals, an organisation acting in the interests of a defined group it represents may, subject to the permission of the Competition Tribunal, bring representative actions. In deciding whether a permission should be granted, the Competition Tribunal must be satisfied the body concerned can fairly and adequately represent the interests of the relevant parties.

A representative action may allow actions to be brought on behalf of parties who are unwilling or having difficulties to spend the time and costs to bring the action as any loss they individually may have suffered will not be significant enough to justify the investment. However, the aggregate loss these consumers or parties collectively suffer may be significant. Representative actions can also increase the deterrent effect of the Proposed Competition Law if businesses engaged in anti-competition conducts may find themselves liable to all those who suffer.

Representative action is new to the Hong Kong legal system, and the Hong Kong government is yet to set out a comprehensive code in relation to the conduct of representative actions brought before the Competition Tribunal. In time, the government will need to provide guidance on issues such as the standing of the representative, legal costs and the distribution of damages awarded.

DEBATES ON THE EFFECTIVENESS OF PRIVATE ACTIONS

In many jurisdictions, private enforcement of competition law is actively encouraged, but the volume of such cases has been relatively low - in part due to the economic and evidential complexities that must be dealt with to bring successful private actions in this area.

It remains to be seen whether such issues will limit the effectiveness of “stand alone” private actions under to Hong Kong’s Proposed Competition Law.

However, it is generally accepted that making private actions available will add a net benefit to the enforcement of the Proposed Competition Law, by making it more accessible and increasing deterrent effect on potential wrongdoers.

Key publications since the last edition of Competitive Edge

The following client alerts and industry watch alerts relating to China and Hong Kong competition laws have been published since our April edition of Competitive Edge:

- New Guidance on the Application of China’s Merger Control Regime to the Financial Industry (24 July 2009)
- Statutory bodies and Hong Kong’s proposed competition law - Exempt or Exposed? (June 2009)
- China Publishes Draft Rules Relating to Anti-Monopoly Law ‘Monopoly Agreement’ Provisions (15 May 2009)
- China Publishes Draft Rules Relating to Anti-Monopoly Law ‘Abuse of Dominance’ Provisions (13 May 2009)
- PRC Uses Anti-Monopoly Law to Place Conditions on Mitsubishi Rayon’s Acquisition of Lucite (27 April 2009)

If you are not already a subscriber to JSM’s Antitrust & Competition Team client alerts, please email contact.edits@mayerbrown.com for registration. Additionally, you can visit our dedicated China Anti-Monopoly Law web page at www.mayerbrown.com/chinaantimonopolylaw/

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