



EVERYTHING MATTERS

THE ANTI-MONOPOLY LAW OF THE PEOPLE'S REPUBLIC OF CHINA

A Business Guide



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INTRODUCTION AND OVERVIEW

China's Anti-Monopoly Law (the "AML") was promulgated by the National People's Congress on 30 August 2007 and came into force on 1 August 2008.

These provisions had been the subject of protracted debate within China for over a decade before being passed into law and they mark a significant step towards China's full participation in the global economy.

Previously, China had had various fragmented pieces of legislation which covered certain aspects of what could be classified as competition law, but the legislation was incomplete, little enforced and included some elements more consistent with a system of "command and control" than a market economy. The AML is China's first general competition law. It is expected, therefore, that the AML will prevail over any earlier legislation (which has not been expressly repealed).

GLOBALISATION

China is the last of the major world markets to acquire a general competition regime. Apart from the established systems in place for many years in the US, the EU, Japan, Canada, Australia & New Zealand and the other so-called "BRIC"s (Brazil, India, Russia and China), many other economies in the Asia-Pacific region also have competition law regimes e.g. Singapore, Korea, Taiwan and the Philippines, Vietnam and Hong Kong is on

the point of introducing its own general competition legislation. So, with AML, the last major piece of the jigsaw in a globalised system of competition law falls into place.

Consequently, competition law is no longer a localised consideration only to be focused on when doing deals in certain jurisdictions, but has become a universal consideration to be taken into account whenever doing deals around the world, particularly when the AML has, like a number of other legal systems, extra-territorial implications which, as we will see below, may catch agreements and transactions concluded outside China.

The AML includes similar elements to those covered in many other systems of competition law:

- Merger Control;
- Monopoly Agreements (i.e. restrictive agreements/restraints of trade);
- Abuses of Dominant Position.

The AML has, in fact, been modelled on EU competition law.

MERGER CONTROL

Prior to the AML, only foreign investors were required to file merger notifications before taking over Chinese companies or creating joint ventures in China.

Under the AML, all concentrations have to be notified to MOFCOM if certain thresholds are met. For an explanation of who the regulators are, please see below.

WHAT IS A “CONCENTRATION”?

A concentration of undertakings occurs in any one of the following circumstances:

- A merger of two or more previously independent undertakings;
- Acquisition of control of other undertakings through an acquisition of shares or assets;
- Acquisition of control or acquiring the ability of exercising decisive influence over other undertakings by contract or other means;
- Creation of a joint venture appears to fall within the definition of a “concentration”.

It should be noted that concentrations of undertakings outside China that restrict or eliminate competition in the Chinese domestic market will fall under the AML.

THE NEW THRESHOLDS

If either of the two thresholds below is met, a merger notification must be filed with the Ministry of Commerce (usually referred to as “MOFCOM”) otherwise the concentration is prohibited:

- The total worldwide turnover in the previous accounting year of

all undertakings involved in the concentration exceeds RMB 10 billion [approximately US\$1.4 billion or Euro 933 million or £739 million], and at least two of such undertakings each has a turnover of more than RMB 400 million [approximately \$ 59 million or Euro 37 million or £29 million] within China in the previous accounting year; or

- The total turnover in China in the previous accounting year of all undertakings involved in the concentration exceeds RMB 2 billion [approximately US\$ 293 million or Euro 187 million or £147 million], and at least two of such undertakings each has a turnover of more than RMB 400 million [approximately \$ 59 million or Euro 37 million or £29 million] within China in the previous accounting year.

THE PROCEDURE

MOFCOM will have 30 days to conduct a preliminary review of the transaction. At the end of the 30 day period, MOFCOM can decide to conduct a further review or decide that no further review is required. If MOFCOM makes no decision within the 30 days, the parties may implement the transaction.

Where MOFCOM decides to conduct a further review, it shall have 90 days to complete such review. In certain circumstances, it may notify the parties

that the review period will be extended and in such case, the 90 day period may be extended by up to an additional 60 days. At the end of the period of further review, MOFCOM may prohibit the concentration or may attach conditions to the implementation of the concentration. If it makes no decision at the expiry of the period of further review, the parties are free to implement the concentration.

In making its review, MOFCOM will have regard to a number of broad economic factors, notably the market shares of the participating undertakings in the relevant markets, the degree of concentration in those markets, the possible foreclosure effects, effects on technological advancement, effects on consumers and other market participants, effects on the development of the Chinese national economy and possibly other factors which may affect competition in the market. A concentration may be prohibited where it may have the effect of eliminating or restricting competition. However, MOFCOM may make a decision not to prohibit a concentration that may have the effect of eliminating or restricting competition if it is satisfied that the positive effects of such concentration outweigh the negative effects or that it is in the public interest.

GENERAL POWERS OF REVIEW

Even where the turnover thresholds are not met, if MOFCOM considers that a concentration may result in the elimination or restriction of competition in the Chinese domestic market, it has the power on its own initiative to investigate the concentration. It is to be anticipated that MOFCOM will be monitoring on a systematic basis those concentrations that are not notified to see if any of them merits investigation.

FILING REQUIREMENTS

Guidelines for merger filings under the AML have not been issued. The filing guidelines used under the old law will continue to be used for filings under the AML. It remains to be seen whether MOFCOM will issue amendments later in the light of experience gained with the AML. One important point to be noted is that the parties should have pre-notification discussions with MOFCOM before any filing is made to identify relevant competition issues, if any.

NATIONAL SECURITY REVIEW

In the case of the acquisition of Chinese enterprises by foreign capital or the participation of foreign capital in a concentration, where an issue of Chinese “national security” is involved, a national security review will be conducted at the same time as the merger assessment. The notion of “national security” is not defined in the AML.

MONOPOLY AGREEMENTS

The AML defines “monopoly agreements” as being “agreements, decisions or other concerted behaviour that eliminate or restrict competition” within the PRC.

The AML also explicitly provides that it applies to monopoly agreements concluded outside the PRC which have the effect of “eliminating or restricting competition” in the domestic market of the PRC. Therefore for example, agreements concluded between foreign companies in Europe or the USA to divide up world markets could infringe the AML. Similarly, concentrations between companies outside China could also fall within the scope of the AML if the effect of the concentration were to eliminate or restrict competition in the Chinese domestic market.

AGREEMENTS BETWEEN COMPETITORS

Certain types of horizontal agreements (or agreements between competitors) are forbidden in the law, notably:

- Price fixing;
- Output or sales restrictions;
- Market sharing;
- Restrictions on purchase of new technology or new facilities or on development of new technology or new products;
- Collective boycotts.

Unless the agreement can be exempted on one of the grounds set out below (please see “Exemptions” below). The above list can be extended by administrative decision.

However, a violation is only committed when such an agreement “eliminates or restricts competition”; there are no “per se” violations.

AGREEMENTS BETWEEN PARTIES AT DIFFERENT LEVELS IN THE SUPPLY CHAIN

In the case of vertical agreements, fixing resale prices and restricting minimum resale prices are both forbidden unless the agreement can be exempted (Please see below). But again, there are no “per se” violations as such.

EXEMPTIONS

Horizontal or vertical monopoly agreements may however be exempted on any one of the following grounds:

- Improving technology or research or for new product development;
- Cost reduction, improving efficiency and product quality, implementing specialisation and product standardisation;
- Enhancing the competitiveness of small and medium sized enterprises;
- Serving public interests, like environmental protection, energy conservation etc;
- Mitigating a glut on the market in times of economic recession; or
- Protecting the legitimate interests of foreign trade and foreign economic cooperation.

In all cases except the last one, the company seeking an exemption on the basis of one of the above grounds will also have to prove that the agreement satisfies two additional conditions:

- The agreement will not seriously restrict competition in the relevant market; and
- Consumers will be able to share in the benefits derived from the agreement.

ABUSE OF DOMINANT POSITION

It is not an infringement to have a dominant market position.
Mere dominance is not a violation of the AML.

Concentration through fair competition and mergers in accordance with the law and in order to expand scale of operations and to improve market competitiveness, are encouraged in the AML.

It is, however, an infringement when a company with a dominant position abuses that position, by taking certain actions to eliminate or restrict competition.

“Dominant market position” is defined in the AML as the market position that is held by undertakings in the relevant market which enables those undertakings to control the price and quantity of goods or other trading conditions, or to block or affect the entry of other undertakings into the relevant market.

A rebuttable presumption of “dominant market position” would arise if a company holds a substantial share in the market. The AML provides that a rebuttable presumption of dominance will arise where:

- One company holds 50% or more of the relevant market;
- Two companies jointly account for 66.6% or more of the relevant market; or
- Three companies jointly account for 75% or more of the relevant market.

But where a company has less than a 10% market share, it will be presumed not to have a dominant position

Behaviour that may be considered as an “abuse” includes:

- Selling goods at unfairly high prices or buying at unfairly low prices;
- Selling goods at prices below the cost without justified reasons;

- Refusing to deal with another party without justified reasons;
- Requiring another party to trade exclusively without justified reasons;
- Tying products or imposing other supplementary unreasonable trading conditions without justified reasons; and
- Using discriminatory pricing and other discriminatory trading conditions without justified reasons.

Despite the rebuttable presumptions that are included in the AML, the existence of dominance remains a very complex subject which goes well beyond the assessment of market shares.

INTELLECTUAL PROPERTY RIGHTS

Article 55 of the AML provides that it shall not apply to the exercise of intellectual property rights (IPRs), but it will apply where the holder of the IPR abuses his rights “to eliminate or restrict competition”. This rather vague provision seems to envisage that a refusal to licence an IPR may, in certain circumstances, be an abuse where it can be shown that such refusal is for the purposes of eliminating or restricting competition rather than exploiting the right by the obtaining of reasonable royalties.

STATE-OWNED ENTERPRISES

The AML also prohibits the abuse of government administrative powers. State Owned Enterprises or enterprises controlled by State Owned Enterprises are prohibited from using their dominant position or exclusive dealing position to harm consumers' welfare.

REGULATORS AND ENFORCEMENT

Regulation and enforcement of anti competitive conduct will be split between two different bodies: the Anti Monopoly Commission and the State Council Anti Monopoly Enforcement Authority.

The Anti Monopoly Commission will be responsible for organising, coordinating and guiding anti monopoly work. Its duties will include researching and drafting policies and guidelines, organising investigations and assessing the overall competition status in the market.

The State Council Anti Monopoly Enforcement Authority (the “Enforcement Authority”); will, in fact, comprise of three different enforcement agencies, each responsible for a different areas of the AML:

- Ministry of Commerce (“MOFCOM”) will be responsible for Merger Control;
- National Development and Reform Commission (“NDRC”) will be responsible for price-related Monopoly Agreements and price-related Abuses of Dominant Position; and

- State Administration for Industry and Commerce (“SAIC”) will be responsible for the non-price related Monopoly Agreements and non-price Abuses of Dominant Market Position.

The Enforcement Authority has been granted very wide ranging powers to investigate, determine liability and impose penalties. It has the power to compel a person to provide information or produce documents as well as the power to compel attendance and to search premises. Further, the Enforcement Authority may delegate powers to relevant provincial governments, autonomous regions and municipalities.

FINES AND PENALTIES

Infringement can lead to severe penalties. Maximum fines could be as high as 10% of total turnover during the last (fiscal) year. Article 46 of the AML also provides that violations may result in the confiscation of illegal gains.

There may also be criminal liability. Individuals and companies who refuse to provide relevant materials or information, or who provide false or misleading information, destroy evidence or obstruct the investigation, may be liable to criminal sanctions.

The AML also envisages private enforcement action by third parties against violators who cause losses to others.

LENIENCY

Where a party voluntarily reports relevant information concerning monopoly agreements and provides important evidence, the Enforcement Authority is empowered to mitigate or exempt the punishment of such a party involved in the agreement.

It is vital, therefore, that companies implement and run an effective compliance program, to be able to detect potential infringements at the earliest possible moment. For an explanation of what is involved in setting up and running a compliance program, please see Annex I.

CARVE OUTS AND SPECIAL PROVISIONS

As we have seen earlier, there are certain public interest exemptions for monopoly agreements.

The AML also recognises the lawful status of:

- Industries controlled by the State that are considered to have a vital bearing on the lifeline of the Chinese national economy and national security, such as telecommunications, energy and banking;
- Industries which have exclusive operation and sales arrangements under Chinese law, such as petroleum and tobacco.

These industries have special obligations under the AML to operate in accordance

with their specific legal regimes subject to public supervision and also to act in good faith and not to harm consumer interests by abusing their dominant position or exclusive sales position.

The AML is not applicable to joint or concerted action of agricultural producers or agricultural sales organisations relating to agricultural products.

It is to be noted that administrative bodies and agencies in China may not abuse their powers so as to eliminate or restrict competition.

CONCLUSIONS AND PRACTICAL CONSIDERATIONS

For businesses, there are three main areas of focus:

- Merger control;
- Monopoly agreements;
- Dominant positions.

HOW SHOULD EACH ONE BE TACKLED?

Mergers and Joint Ventures

It is essential that all merger transactions which involve China in any way should be reviewed **at the planning stage**. This concerns not only acquisitions, but also joint ventures.

A feasibility study should be made while the transaction is being considered and before negotiations are completed four basic questions should be asked:

- Are the filing thresholds going to be met? (Filing obligatory).
- Is it likely that the transaction could be considered to “eliminate or restrict competition” in China? (Beware of a spontaneous review by MOFCOM even if the thresholds are not met).
- Could “national security” be a potential concern?
- Are domestic Chinese competitors likely to complain?

Procedure should be planned: it is essential to have pre-notification discussions with MOFCOM officials.

Multi-jurisdictional filings should be carefully coordinated through an overall filing strategy.

Coordination of implementation is critical.

MONOPOLY AGREEMENTS

Current agreements and practices should be reviewed and those that could fall within the definition of monopoly agreements should be considered and the risks evaluated of potential enforcement action. Going forward, each company should consider how best it can manage the risks involved in the negotiation of new agreements and its future business practices. Usually, such risks can only be managed effectively and at reasonable cost by setting up a compliance program which is adapted to the scale and culture of the particular organisation. As leniency is a part of the AML, effective compliance should be a high priority for companies. There is a brief explanation in Annex I of what a compliance program usually involves.

ABUSE OF DOMINANT POSITION

Determining with certainty whether a dominant position exists in any particular case is often a complex exercise. It is much more practicable to identify those situations of potential dominance. AML itself sets out some situations of potential dominance when it indicates the presumptions set out above, namely where:

One company holds 50% or more of the relevant market;

- Two companies jointly account for 66.6% or more of the relevant market; or
- Three companies jointly account for 75% or more of the relevant market.

Apart from the three instances set out in the AML, in our experience situations of potential dominance can often occur where one company has a market share in the region of 35%-40%. and the other market participants are small.

A simple way for companies to identify their situations of potential dominance, is once a year at budget time to ask each business director to indicate the markets that his business is present in and to assess

his market shares and those of his major competitors. If he has to make a sales forecast for the coming year, he has to go through this process anyway, although he might not normally write it down. Now, he should be asked to write it down on the basis of his best estimates, and making clear that his estimates may not be 100% accurate.

Where situations of potential dominance are thus identified, the business director and staff should be told that certain decisions or actions with respect to those markets cannot be taken without seeking prior legal advice, essentially these would be:

- Setting pricing and discounting policy;
- Creating bonus or incentive schemes for customers;
- Selling goods at prices below cost;
- Refusing to deal with another party;
- Exclusive dealing;
- Tying products or imposing other supplementary trading conditions; and
- Using discriminatory pricing or discriminating between customers.

Any of such decisions or actions would then have to be subject to a specific legal review to evaluate possible justifications and the legal risks involved.

No summary this kind can cover all the aspects of a complex new piece of legislation like the AML. Furthermore, competition law is not an exact science and regulators often have a wide measure of discretion in interpreting and applying the law in particular cases. This guide is only intended as a general introduction to the AML and cannot be relied upon as legal advice in any specific case.

Further information and specific advice can be obtained from our experienced team of specialists whose contact details are set out below.

ANNEX I: COMPLIANCE PROGRAMS

A compliance programme can be described as an internal system set up by any organisation for the purpose of ensuring compliance with a particular body of rules and for managing the risks that arise out of the application of those rules. In brief, it can be said to be a set of internal guidelines, but in fact, it is much more than a set of internal rules. It is also the way in which such rules are applied and enforced within the particular organisation and in that sense, it is also a system of management. This element is crucial, because it means that the entire management of the particular organisation, from the top down to the most junior manager, should be involved in and committed to such a programme. Also, like most systems of management, compliance programmes can be judged on only one criterion: results.

The consequence of this is that there is no perfect model for a compliance programme. Each organisation should devise a programme that will be effective for itself, in other words, taking into

account its own culture, its scale, its individual businesses and its history.

However, while bearing this in mind, one can, nonetheless, say that compliance programmes usually include the following elements:

- **A mission statement by top management:** setting out the reasons why the compliance programme is essential to the whole organisation (no compliance programme will be effective without the wholehearted and visible leadership of top management);
- **Education:** teaching managers and employees what the basic rules and procedures are and what the “do’s and don’t s” are of everyday business conduct; this can take the form of a brochure or an intranet site or an online website which sets out the basic rules and which is easily accessible; It is very important that new employees and new managers are quickly introduced to the basic rules and procedures.

- **Help and advice:** when managers and employees have questions or encounter difficulties, they should be able to turn to a qualified person (usually a compliance officer) for rapid help and advice;
- **Monitoring:** there should be a regular system of monitoring compliance by everyone. This can be done by requiring every senior employee and manager to certify in writing periodically (perhaps once a year) that he or she is not aware of any breaches of the rules (and if they are aware of breaches, they should report them). In some cases, periodic compliance audits by senior managers or the compliance officer may be appropriate;
- **Updating:** there should be regular seminars to refresh the knowledge of managers and employees and to update them on new developments.

What should be noted about the above, is that although outside specialists can advise on how to set up a compliance programme, the setting up and the running of the programme has to be carried out by the organisation's own management.

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