

# CHINA MATTERS

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## China Adopts First Antimonopoly Law

On August 30, the Standing Committee of the National People's Congress adopted the Antimonopoly Law of the People's Republic of China (the "AML") after 13 years of drafting and deliberation and much anticipation by companies active in the Chinese market or competing against Chinese producers.

The AML in many respects reflects the broad global consensus that has emerged over the last two decades on the scope and reach of competition law. Its principles and terminology will not be unfamiliar to anyone with basic exposure to U.S. and European antitrust rules.

The most important questions about the new AML, however, are not answered by the statutory language itself - how the State Council will establish standards for merger review, how geographic and product markets will be defined, with what force the government will enforce the new provisions and standards, and whether the new law will be applied in a manner that benefits domestic Chinese producers over global competitors seeking to penetrate the Chinese market.

Resolution of those questions will be closely watched over the next 12 months as the AML's effective date - August 1, 2008 - approaches. The one-year grace period for the effectiveness of the AML is designed to allow the State Council sufficient time to prepare to enforce the new law, to establish the new Antimonopoly Commission and enforcement agencies, and to develop implementing rules and guidelines.

### KEY PROVISIONS OF THE AML

#### Geographic Scope

- The AML applies to (i) any monopolistic conduct in economic activities within the territory of the

PRC and (ii) any monopolistic conduct outside of the territory of the PRC that eliminates or has restrictive effects on market competition in the PRC (Article 2).

#### Creation of the Antimonopoly Commission

- Currently, more than 10 governmental agencies are responsible for enforcing provisions relating to antitrust and unfair competition principles, including the Ministry of Commerce ("MOFCOM"), the State Administration of Industry and Commerce ("SAIC") and the National Development and Reform Commission ("NDRC"). The AML attempts to centralize enforcement by requiring the State Council to designate enforcement institutions and create an Antimonopoly Commission, which will be responsible for organization, coordination, and supervision of the new antimonopoly enforcement regime (Article 9).

- It is noteworthy that China chose to create an agency responsible for coordination and oversight of designated antitrust enforcement institutions. It is likely anticipated that conflicts will arise among the ministries and various enforcement institutions as the new law is implemented, and the structure adopted is designed to help centralize authority and designate a commission focused solely on, and able to develop expertise in, antitrust issues.

#### Penalties

- Penalties for violations of the AML (except in the case of concentrations) include orders to cease anticompetitive conduct, confiscation of illegal gains, and fines of 1-10% of annual turnover (Articles 46-48).

- While there is no official leniency program, Article 46 provides that the enforcement institutions may reduce or exempt the penalty for companies who voluntarily come forward with material evidence of monopoly agreements.

### **Private Litigation**

- The AML specifically provides for a private right of action in civil litigation (Article 50).
  - This private litigation remedy could be among the AML's most interesting features. Historically there have been relatively few private antitrust cases, and the Chinese courts have limited track records in lawsuits involving complex economic analysis of markets and antitrust damages.

### **Prohibited Conduct**

- **Horizontal and Vertical Monopoly Agreements.** The AML prohibits horizontal monopoly agreements between competitors that fix prices, restrict production or sales volume, allocate markets, restrict purchase or development of new technology or equipment, or constitute joint boycotts (Article 13). It also prohibits vertical monopoly agreements between upstream suppliers and downstream buyers that fix resale prices to a third party or restrict the minimum price for resale (Article 14). However, a monopoly agreement may not be illegal if it is proved that it has certain positive effects, such as improvement of technology, increased product quality and reduced costs, or conservation of energy and the environment (Article 15).
  - The AML takes the same approach to horizontal and vertical agreements. It thus appears to adopt a "rule of reason" rather than "per se" approach even to hardcore horizontal conduct such as price-fixing. Bid-rigging is not expressly listed as an example of a prohibited horizontal monopoly agreement under the AML, but it is prohibited under the Unfair Competition Law, Article 15.
- **Abuse of Dominant Market Position.** The AML prohibits operators having a dominant market position from abusing their market power through unfairly high or low pricing (including selling below cost), refusals to deal, exclusive dealing, tying, or discriminatory pricing, if such conduct is unjustified or without legitimate reason (Article

17). There is a presumption of dominant market position if a company possesses 50% or greater market share in the relevant market. Dominant market position is also presumed for more than one company if two operators have a combined market share of 2/3 or more or three operators have a combined market share of 3/4 or more (Article 19).

- A last-round revision to the AML provides that the presumption can be rebutted by proving the absence of dominant market position, presumably through evidence relating to factors set forth in Article 18 as indicia of market power, such as ability to control prices, quantities, distribution or procurement, entry barriers, and other market conditions.
  - Application of these presumptions and how product and geographic markets will be defined will prove critical in industries in which global consolidation has occurred, leaving a small number of principal producers who often are competing with recently-established Chinese producers.
- **Concentration of Operators.** The AML prohibits concentrations (mergers and acquisitions) that eliminate or restrict competition, unless the favorable competitive effects are substantially greater than the unfavorable effects of the transaction or the transaction is in the public interest (Articles 20 and 28). The AML codifies a reporting and review procedure for mergers and acquisitions under the province of the State Council-appointed antimonopoly enforcement authorities. While it does not provide for specific reporting thresholds, it authorizes the State Council to promulgate them.
  - With respect to foreign investors, transactions are subject not only to concentration review under the AML, but also to national security review (Article 31). These provisions appear similar in aim to the Exon-Florio rules in U.S. law (albeit broader), and will open an additional area of attention when foreign companies seek acquisitions or investment partnerships that take advantage of growing Chinese technological innovations.

- **Administrative Monopolies.** The AML prohibits administrative authorities and public organizations from abusing their administrative power to hinder or restrict competition through discriminatory treatment and other exclusive or restrictive conduct (Articles 32-37).

■ **Industry Associations.** An eleventh-hour revision to the final draft of the AML adds prohibitions on industry associations' facilitation of monopoly agreements among its members (Article 16). The AML sets a fine of 500,000 RMB for industry association violations (about US\$60,000) (Article 46), which appears small by Western standards but could amount to a large portion of the budget of most Chinese industry "chambers."

- Assuring antitrust compliance by trade associations is a complex task in U.S. and European jurisdictions, and given the important role of industry chambers in China, the same may prove true under the AML.

■ **Abuse of Intellectual Property Rights.** While the AML does not apply to the exercise of intellectual property rights in accordance with the intellectual property laws and administrative regulations, it is applicable to the abuse of intellectual property by companies to eliminate or restrict competition (Article 55).

- The drafters have explicitly stated that this provision was meant to address a perceived abuse of intellectual property rights in the PRC, especially by large companies and enterprises; however, the AML contains no definition of "abuse" or any guidance as to how the line will be drawn between abuse and legitimate use of intellectual property rights.

The long-awaited adoption of a comprehensive China antimonopoly act is undoubtedly an important step toward clarifying and unifying antitrust and unfair competition principles previously enforced through multiple governmental bodies. It adopts business standards that, until recently, would have been thought foreign to the workings of much of the Chinese economy. The new law leaves many issues and concerns unresolved, however, and development of implementing rules and guidelines by the new Antimonopoly Commission will determine whether the AML becomes a significant force in how business is done in China.

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