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China's New Anti-Monopoly Law

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Overview

China passed its first anti-trust (anti-competition) statute in 2008. Dan Wei, *Antitrust in China: An Overview of Recent Implementation of Anti-Monopoly Law*, 14 European Bus. Org. L. Rev. 119, 121 (2013). It is called the Anti-Monopoly Law (AML), and it was debated and worked on for two decades before it was passed and made into law. *Id*. The AML targets three broad categories of monopolistic behavior: monopoly agreements, abuse of dominance, and anti-competitive concentrations. *Id*. Exceptions are made for industries that are controlled by the state-owned economy and that are critical to the wellbeing of the national economy and national security, as well as industries in which exclusive operation and exclusive sales are the norm of business in accordance with the law. Di Federico, G., *The New Anti-monopoly Law in China from a European Perspective*, 32 World Competition 249, 252 (2009). Before the AML's passage, antitrust provisions were spread across nearly 40 separate laws. Wei, *supra*, 121.

Why was the AML enacted?

It can be difficult to speculate on this question since many of the behind-the-scenes discussions are not available for public viewing. Wentong Zheng, *Transplanting Antitrust in China: Economic Transition, Market Structure, and State Control*, 32 U. Pa. J. Int'l L. 643, 716 (2010). However, there is public information available on the drafting process that can shed light on what the "original intent" of the law was. *Id*. Chief among the driving motivators behind the AML were the government's desires to promote the development of the market and contain abusive state power. *Id*. at 717. However, these factors did not seem to be an easy sell, as anticompetitive law was first placed on the legislative agenda in 1994. *Id*. The legislation was tabled for more than a decade, when it was suddenly revived and "expedited" in 2004. *Id*. at 718. The driving force behind this was allegations of monopolistic behavior of foreign firms in

China, specifically Tetra Pak in 2003. *Id*. The government began to conduct investigations and concluded that foreign companies may begin a trend of monopolizing Chinese markets.

What seemed to cause this increase in foreign firms' dominance in the Chinese markets was China's ascension to the WTO in 2001. *Id*. at 719. Part of their membership requirements was a reduction in tariffs and allowing trade in a larger number of sectors. This resulted in enhanced access by foreign firms in China's markets, as many of the government's tools for shielding Chinese companies against multinational companies were removed. *Id*. The main drafting focus behind the AML, then, seems to have been a concern with foreign multinational companies in China, with minor efforts dedicated to regulating domestic firms so as to give the appearance of a fair and modern anticompetition law. *Id*. at 720

Enforcement

The AML emphasizes administrative enforcement over judicial enforcement, and the agencies are divided primarily into two groups: the Anti-Monopoly Commission of the State Council (AMC) and the Anti-Monopoly Enforcement Authority (AMEA). Wei, *supra*, at 121. The Anti-Monopoly Commission has legislative-type powers, capable of drafting competition policies, releasing assessment reports, and formulating competition guidelines. *Id*. The Anti-Monopoly Enforcement Authority is the umbrella agency for the Anti-Monopoly Bureau of the Ministry of Commerce (MOFCOM), which is responsible of merger review, the Department of Price Supervision, which is responsible for enforcing pricing and disbanding cartels, and the Anti-Unfair Competition Enforcement Bureau which is charged with monitoring non-price related abuse. *Id*.

The AML provides for several means of enforcement of the law, such as fines, sanctions, and criminal charges. *Id*. at 122. If a business owner discloses a monopoly agreement, he is granted leniency when punishment is imposed for the monopolistic behavior. *Id*. at 123. The main mechanism of enforcement is fines. *Id*. When business reach and fulfill a monopoly agreement, or when a business abuses its dominate market position, the administering agencies may impose fines between 1% and 10% of the previous year's sales revenue. *Id*. When imposing fines, the agency is supposed to consider the nature, extent, and duration of the violation. *Id*. If someone obstructs an investigation, they can face fines or criminal charges. For government officials that abuse their power, disciplinary sanctions and criminal charges can be filed by the enforcement agencies. *Id*.

Drawbacks and Shortcomings of the Enforcement Provisions

In addition to the AMC and AMEA agencies created above to enforce the AML, three other agencies are responsible for enforcing the AML: the State Administration for Industry and Commerce (SAIC), the National Development and Reform Commission (NDRC), and MOCOM. Di Federico, *supra*, at 263. There are two main shortcomings of enforcing the AML by multiple agencies each at different levels of government with differing functions: 1) possible conflicts of jurisdiction under the AML and other existing regulations, and 2) conflicts of capabilities under the AML and other existing regulations. *Id*. For example, the same practice could be caught by the AML and other industry regulations, such as the 2000 Telecommunications Regulation. *Id*. It is also possible to imagine a predatory pricing situation that would be evaluated by NDRC for monopolistic pricing behavior and by SAIC as an abuse of a dominate position. *Id*. at 264. What complicates things further is that the AML offers no guidance on what law should prevail and how to avoid political bias.

Having three parallel enforcement agencies likely will lead to conflict and friction, fragmentation, and incoherent decision making. Angela Huyue Zhang, *The enforcement of the Anti-Monopoly Law in China: An institutional design perspective*, 56 Antitrust Bulletin 631, 640 (2011). In 2011, SAIC and NDRC adopted implementation rules for the AML, which showed an attempt to delineate a division of labor between the two agencies. *Id*. at 641. With regard to restrictive agreements, NDRC is mainly responsible for enforcement against price fixing and SAIC is mainly responsible for restrictions in output or sales. *Id*. For an abuse of dominate position, SAIC is primarily responsible for refusal to deal, exclusive dealing, bundling, and discriminatory treatment, while NDRC is primarily responsible for resale price maintenance, unfairly high or low prices, exclusive dealings through price discounts, and the imposition of unreasonable fees. *Id*. Despite this, there are still many areas of ambiguity that could trigger the jurisdiction of both agencies, and neither has provided guidance on how to handle issues that would be addressed by both agencies. *Id*. at 643. A recent example of a case where there was dual jurisdiction suggests the agencies may be deciding who addresses the issue on an ad hoc basis. *Id*. At a paper-manufacturing association meeting, the members decided agreed to raise prices and limit output. This required both SAIC and NDRC to intervene but only NDRC did so. It may actually have been possible that SAIC was not even aware of the case at the time NDRC was conducting its investigation. *Id*.

Benefits of having three enforcement agencies

A benefit of having three separate enforcement agencies is the fact that it is decentralized, which might have the effect of creating competition in enforcement. *Id*. at 644. Diversified enforcement could provide the opportunity to test different enforcement options, and also guard against the risk of any one agencies failing to carry out its duties, or carrying them out in a poor and mismanaged way. *Id*. In fact, a centralized enforcement system, such has in Japan, has its drawbacks. Some have argued that Japan's Fair Trade Commission is weaker than it otherwise would be if it were required to cooperate and compete among various enforcement agencies. *Id*.

Indeed, in the United States both the Department of Justice and the Federal Trade Commission are charged with antitrust enforcement. *Id*. at 645. But despite them sharing enforcement responsibilities for decades, the dual enforcement model in the US has always been hotly debated, as dual enforcement creates duplicate overheads. *Id*. Cooperation to limit unnecessary duplication is costly, as cooperation and communication between the two agencies is neither easy nor inexpensive. Furthermore, businesses also incur more compliance costs as a result of having to meet the standards and idiosyncrasies of both government agencies. *Id*.

Mergers

Before the beginning of a merger transaction, the merging companies must give the Chinese administering authorities notification. Wei, *supra*, at 124. Before this notification, informal discussion with the authorities is encouraged, in the hopes that the merger review process is more transparent and the certainty of granting the merger can bolster the businesses' confidence in conducting the concentration. *Id*.

The merging parties are required to prove that the merger will not adversely affect competition. This raises several concerns, such as cost, bias, and rent-seeking. It can be very cumbersome and costly for a business to gather the requisite data on the market structure and impacts on the market structure resulting from the concentration. *Id*. Furthermore, when entities are paid to conduct market studies and analysis, this raises doubts as to their credibility and independence. *Id*. In addition, there are no concrete rules specifying the weight such studies and documents have in the merger review process. *Id*. This creates a prime environment for rent-seeking and lobbying

Mergers – Standard of Review

The focus of review is the potential effect of a concentration. *Id*. at 125. What would prevent a merger is if MOFCOM thought that a concentration has, or would likely have, the effect of eliminating or restricting competition. *Id*. There are, however, two exceptions to this rule: if the beneficial effects would exceed the adverse effects, or if the merger advances the public interests. *Id*. Examples of such situations are achieving energy savings, protecting the environment, a mitigation of a severe decrease in sales volume or excessive overstock during an economic recession, and to safeguard the interests in foreign trade. Di Federico, *supra*, at 254. The definition of market used in this analysis is broad. In the United States and Europe, the focus of the inquiry is on the specific product market in question. Wei, *supra*, 125. In China, the definition takes on a product dimension and a geographic dimension. The factors considered for the product market are the product's characteristics, prices, and intended use. *Id*. The geographic market is defined as the scope of the geographic area in which consumers can acquire the commodity. *Id*.

Nationalism as a decision-making factor?

There are two recent merger decisions made by MOFCOM that raise strong suspicions of nationalism as a driving factor in MOFCOM's denials and restrictions of mergers. The two mergers were InBev/Anheuser-Busch and Coca-Cola/Huiyuan. *Id*. at 127. The acquisition of Anheuser-Busch by InBev was allowed, but it was conditional. *Id*. at 128. The conditions were that InBev could not increase its shareholdings in three other Chinese brewing companies, and

Anheuser could not increase its shareholdings of Tsingtao Beer. *Id*. Their reasoning contained very little by way of a market analysis of the impacts of the merger, and instead was based on broad statements regarding the massive scale of the merger and the high market share the post-merger company would possess. *Id*. In the United States and Europe, a merger would be cleared if it was found to not be anticompetitive. *Id*. The driving decision in this merger case seemed to be MOFCOM's concern that foreign firms might gain control over Chinese firms and the famous Chinese brand Tsingtao. *Id*.

The more troubling of the two decisions was MOFCOM's block of Coca-Cola's purchase of Huiyuan (China's largest juice manufacturer). The reasons MOFCOM blocked the merger were as follows: 1) Coca-Cola would have been able to leverage its dominate market position in the carbonated beverages market within the fruit juice market, harming competition and consumers. *Id*. 2) Coca-Cola would have effective control over the juice market through two well-known brands, Minute Maid and Huiyuan, increasing the barriers to entry in the market. *Id*. 3) The merger would have decreased mid and small-sized firms' ability to compete and innovate, which would impact competition negatively and develop an unhealthy market structure. *Id*. The consensus among antitrust experts outside of China at the time of this decision was that the block was primarily nationalistic and the deal would not have harmed competition. *Id*. at 129. MOFCOM, on the other hand, insists that nationalism was not a basis for the decision. *Id*.

Why MOFCOM seems to only review foreign firms' mergers

Most of China's industries are unconcentrated and spread out among many smaller firms. Zhen, *supra*, at 715. Therefore, when they merge, they are not subject to review by MOFCOM. Also, China has competing policies on what to do regarding mergers of state-owned enterprises (SOEs) that limits the applicability of the AML. *Id*. All these factors coupled together mean that

MOFCOM's reviews, at least for the near future, are likely only going to be on foreign firms' mergers. *Id*.

According to MOFCOM, of the fifty-eight merger notifications they reviewed in 2009, forty involved multinational companies. Zhang, *supra*, 709. This has raised suspicions that MOFCOM is discriminating against foreign companies in its review process, but these may not be well-founded. *Id*. at 710. Most of China's industries are characterized by small-scale firms and low market concentration ratios. Therefore, merger reviews of concentrations among these firms typically would not be, and should not be, initiated.

Another reason MOFCOM and the AML have limited applicability to domestic Chinese firms is due to the treatment of SOE mergers. *Id*. If a domestic industry in China is not characterized by many small firms, it is typically occupied by a monopoly SOE. *Id*. Mergers among SOEs have been very prevalent, but the question is: has MOFCOM been notified of those mergers and have they conducted a review? *Id*. According to the AML, mergers among SOEs should be reviewed, but it is not possible to know which SOE mergers (if any) were reviewed by MOFCOM because they do not publish the identities of the parties to a merger unless the merger is rejected or conditions are imposed on the concentration. *Id*.

(712) Article 22(2) of the AML could be interpreted to allow SOE mergers without review. *Id*. at 712. The provision excepts mergers among private firms that are already subsidiaries of a common parent organization. *Id*. SOEs are all, in a technical way, subsidiaries to the state. *Id*. But the assumption underlying this provision is that subsidiaries to a common parent company are not competitors with one another. *Id*. That assumption does not hold for SOEs, who are supposed to be in competition with one another. *Id*. Therefore, review of SOE mergers should be conducted.

While the issue described above creates a complication for SOE merger review, there is also the problem of competing policy goals that further complicates SOE merger review. *Id*. at 714. China has long had a preference for allowing and encouraging SOE mergers since as far back as the 1980s. *Id*. The first driving consideration of this preference was that industries were highly segmented and it seemed prudent to consolidate them. In addition to addressing market segmentation, the government seemed interested in creating China's "national champions" which was to be achieved by allowing consolidation of SOEs into large, recognizable conglomerates. *Id*. As a result of these competing policy goals, it would be very difficult for MOFCOM to initiate independent review of SOE mergers and override these competing policy goals.

Abuse of Dominant Position

A big difference among anticompetition laws around the world is their definition of dominance. Wei, *supra*, at 132. The AML defines a dominate market position as the ability to control the price or output of production in their relevant market, or the ability to block or affect the entry of similar undertakings in their relevant market. Stephen H. Harris et al., Anti-Monopoly Law and Practice in China 94 (2011). Under the AML, there is a presumption of dominance, that may be rebutted, if one enterprise accounts for half or more of the relevant market, or if two enterprises have a join market share that accounts for more than two thirds of the relevant market, or if three enterprises account for a join market share of more than three quarters of the relevant market. *Id*. This is in contrast to the European process, which makes a determination on a case-by-case basis. *Id*. at 255. The presumption of dominance is intended to ease the work of enforcement agencies, but overlooks three key variables: 1) it is often difficult to calculate the relevant market share, 2) the number of competitors can vary substantially according to the nature of the goods and services in question and how they are defined, and 3) a market economy can be extremely dynamic (255). *Id*. To illustrate, it could be possible that one firm has an 11 percent market share, and two other firms have a 64 percent market share. *Id*. at 97. The firm with only 11 percent will still be presumed to be in violation of the law, which is absurd. Presuming dominance in such a situation increases the regulatory burdens and costs that smaller firms must bear, and could have a chilling effect on economic growth and innovation.

Consider the issue of parallel behavior. Sometimes, raising prices above market equilibrium levels is a natural result of a market dominated by an oligopoly. This can occur, however, absent any collusion. In the US, antitrust law does not act when such behavior exists absent evidence of collusive behavior. *Id*. at 98. The EU takes a somewhat similar approach in what is required to invoke anti-competitive regulations: 1) each member of an oligopoly must know the market behavior of the other oligopolists, 2) tacit collusion must continue over time, 3) the foreseeable actions of current and future competitors and consumers must not be likely to upset the collusion. *Id*. The rules promulgated by SAIC and the NDRC do not contain any provisions akin to those above. *Id*. That is to say, it could be possible that an oligarchy in China that meets the required thresholds set out above would be subject to a presumption of collusion even if they have no practical means to monitor the other's market conduct, or where long term reactions of consumers or competitors would make any present collusion impossible in the future. *Id*. at 99.

The Factors Determining Dominate Market Position

Under the AML, the factors used to consider dominate market position include: market share, competitive conditions in the market, ability of the firm in question to control sales in the market or the purchase of input materials, the financial status of the business operator, dependence of other markets and undertakings on the firm in question, and ease of entry into the market. Evidence of these factors may be used to make an accusation of abuse of dominate market position, or may be used as evidence to rebut the presumption of abuse. *Id*. That is to say, all these factors are considered on the whole, and no single factor is dispositive.

<u>Market Share</u>

Under the AML, firms with 50 percent or more of a market are presumed dominate under the law. *Id*. at 100. In the US, a market share of 70 percent with substantial barriers to entry are considered prima facie evidence of monopoly, and must be rebutted. *Id*. In the EU, 50 percent of the market is considered prima facie evidence, but there is no presumption of dominance. *Id*. Clearly, China places more emphasis on market share than either the US or the EU. In the latter two jurisdictions, market dominance is used as a starting point for investigating abuse of monopoly power, whereas in China market share percentage has a more dispositive effect.

<u>Ability to Control Sales</u>

Regulations promulgated by SAIC consider both the upstream and downstream levels of control (i.e. the ability to control market prices or control over distribution and supply networks). *Id*. at 103. Factors considering when making this determination are: a firm's ability to control sales or purchasing channels, the ability to impact or determine price, output, contract conditions, and priority access to raw materials or equipment needed for production and operation. *Id*.

<u>Barriers to Entry</u>

Barriers to entry are the second most important factor, behind market share, when making a determination of dominance. *Id*. at 105. This makes sense, because the inability of other competitors to profitably enter a market and decrease the dominate firm's share will allow the dominate firm to exert considerable market power, raising prices above equilibrium. Barriers to entry are typically defined as costs that must be borne by new entrants to a market, but are not born by market incumbents. The AML considers factors such as: market access, possession of essential facilities or resources, distribution channels, and financial and technological requirements and costs. *Id*. In the US, typical barriers to entry include: control of natural resources or essential supplies, natural monopolies, intellectual property rights with no substitutes, powerful brand name, high costs of capital, and economies of scale. *Id*.

Pricing

The AML prohibits selling products at unfairly high or low prices. *Id*. at 107. In the EU, a price is considered unfairly high if it is excessive in relation to the value of the product. *Id*. However, enforcement of anti-monopoly provisions is rarely based on unfair pricing alone. *Id*. In the US, however, it is a central idea of competition policy that the market determines the appropriate price. *Id*. Historically, the Chinese government has engaged in price fixing, so it is no surprise that the AML provides no guidelines on how to assess whether a price is unfair. *Id*. Indeed, the provisions setting forth the requirements determining whether a price is high are as follows: the selling price is “obviously higher” than the price paid by other similar undertakings, or the buying price is “obviously lower” than similarly situated undertakings. *Id*. The selling price is increased by a percentage obviously larger than an increase in cost, or the buying price is decreased by a percentage obviously larger than a decrease in costs felt by a trading partner. *Id*. at 108.

Where these provisions fall short is their decision to not focus on maximizing consumer welfare. In truth, the AML seems to punish or deter activity that would be in consumers’ interests. *Id*. The law focuses on the pricing of other competitors and the costs of the firm in question, rather than focusing on whether the prices are the result of competition, or are based on changes in quality, cost, or other factors. *Id*.

Services in the Public Interest

Article 7 of the AML says, "with respect to industries that are controlled by the state-owned economy and that are critical to the wellbeing of the national economy and national security, as well as industries in which exclusive operation and exclusive sales are the norm of business in accordance with the law, the State shall protect the lawful business activities of the undertakings in such industries." Wei, *supra*, 132. This provision is similar to those governing European anti-trust law, which creates special or exclusive rights for businesses that are not normally conducted under free market principles. *Id*. In order to fit anticompetition rules to services such as postal delivery, electric supply, public transportation, social and health services, etc., the rules would have to be altered to the point of becoming inapplicable. *Id*.

Abuse of Administrative Power

A distinctive feature of the AML is its explicit prohibition of administrative monopolies. Di Federico, *supra*, at 261. Chapter 5, Articles 32 to 37 require administrative agencies and organizations who administer public affairs to refrain from using their governmental power to 1) require organization or individuals to deal in, purchase, or use the commodities supplied by the undertakings designated by them, 2) hinder the free flow of commodities among different regions, 3) exclude or restrict the participation of undertakings from other regions in local bidding activities by means such as prescribing discriminatory qualification requirements or standards or by not publishing information according to law, 4) exclude or restrict investment in their region by undertakings from other regions, by applying means such as treatment not equal to what local undertakings are entitled to, 5) compel undertakings to engage in any monopolistic conduct, and 6) make regulations that contain provisions eliminating or restricting competition. *Id*.

These provisions were aimed at deterring two types of behavior that would destroy the purpose of the AML: the distortion of competition resulting from provincial/sectoral regulations and the risk the Chinese provinces and cities would engage in protectionism by supporting and facilitating local enterprises to the detriment of competitors from outside the area. *Id*.

Intellectual Property

Coupled with China's push in passing and enforcing the AML is the nation's interest in passing and enforcing IP law. Harris, *supra*, at 211. Over the past two decades, China's patent office has grown into one of the five largest offices in the world, and litigation has been on the rise in China, with mostly domestic firms suing each other. *Id*.

IP law in China gives owners the right to confer their right to third parties. *Id*. at 222. The EU recognizes this as a good thing, as the ability to trade and transfer IP technology improves economic efficiency, is pro-competitive, and can reduce duplication of research and development, strengthen incentives for additional research and development, facilitate diffusion of technology, and generate market competition. *Id*. However, the ability to grant such use of one's IP rights does not mean holders and using of IP law are outside the scope of competition law. *Id*. The AML's prohibition on monopoly agreements extends to the sharing and use of IP law as well. *Id*.

Obviously, IP agreements between competitors pose a greater risk to competition than agreements made between noncompetitors. *Id*. at 223. However, this is not always automatically the case, as there are situations where agreements between competitors can have some positive competitive benefits. *Id*. at 224. For example, under the AML, agreements between competitors that have the goal of improving techniques, researching and developing new products and that consumers may benefit impartially from the interests derived from the agreement, and that the agreement will not entirely eliminate competition in the firms' relevant market. *Id*.

In Europe and United States, courts and agencies take a more conservative view when deciding whether to subject a business to an obligation to license their IP to a competitor. *Id*. That said, a refusal by a company to license a competitor does not constitute an abuse of a dominate position. The United States takes an even more hands off approach, saying essentially that forcing a business to license a competitor defeats one of the primary purposes of IP law – namely, the ability to restrict others from making, using, or selling products that infringe on the patent. *Id*.

Conclusion

The AML was only recently passed in China, with its primary goal seeming to be regulation of international businesses opening up in China. Enforcement of the law is achieved through administrative agencies, who use fines as the primary means of enforcement. A drawback of the law is it places enforcement into multiple agencies' hands, creating overlapping jurisdictions and the possibility of inefficiently and intra-agency conflict.

The international community has levied accusations of nationalism as a decision-making factor in denying international companies requests to merge with other Chinese companies. MOFCOM has denied such allegations, but the evidence seems to point in the other direction. The AML also differs from the international community in its presumption of a dominate position by the firm's percentage of market share. Such presumptions are designed to ease the burdens on China's regulatory agencies, but they are also arbitrary and raise costs for smaller firms that are likely not in violation of the law.

Overall, the fact that China is taking steps to modernize its economy and enforcement of anti-monopoly practices is a good thing. There are criticisms that we can levy against the design of the law and, perhaps, a biased enforcement of the law. However, we cannot expect perfection, and it is likely that in the future China will become more equitable in their treatment of domestic and international corporations, and the relationship between China and the rest of the developed world can continue to improve and lives can continue to be transformed.