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# Keeping Pace with SAIC: Monopoly Agreements and Abuses of a Dominant Position

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## I. INTRODUCTION

Since the introduction of China's Anti-Monopoly Law ("AML") in August 2008, much of the precedent and practice has focused on China's merger control regime. On January 7, 2011, the State Administration for Industry and Commerce ("SAIC") published regulations concerning non-price-related anticompetitive practices.[2] A few days earlier, on January 4, 2011, the National Development and Reform Commission ("NDRC") published a corresponding set of regulations on price-related anticompetitive conduct.[3]

The regulations adopted by SAIC, which took effect on February 1, 2011, deal with the application of the AML to anticompetitive agreements (or monopoly agreements under the AML), abuses of dominant market position, and abuses of administrative power. They are the first substantive rules issued and, as such, offer insight on how SAIC will enforce the conduct-related provisions of the AML. Far from providing legal certainty and predictability, SAIC's regulations raise questions and leave SAIC with considerable discretion in the enforcement of the AML. This may be inevitable given the relative infancy of China's competition rules but creates risks, compliance burdens, and uncertainty for companies conducting business in China.

This article examines the SAIC Regulation on the Prohibition of Conduct Involving Monopoly Agreements ("SAIC Monopoly Agreements Regulation") and the SAIC Regulation on the Prohibition of Conduct Abusing a Dominant Market Position ("SAIC Abuse of Dominance Regulation") (together "SAIC regulations"), and considers the scope of these regulations while highlighting certain areas of uncertainty. It also considers some of the enforcement issues likely to be encountered as SAIC develops and implements the AML.

## II. BACKGROUND

Enforcement of the AML against anticompetitive practices is divided between SAIC and NDRC, with SAIC enforcing the AML against non-price-related conduct, while NDRC enforces the AML against price-related practices. The AML entrusts the Ministry of Commerce ("MOFCOM") with merger control in China.

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[2] SAIC Regulation on the Prohibition of Conduct Involving Monopoly Agreements, SAIC Regulation on the Prohibition of Conduct Abusing a Dominant Market Position, and SAIC Regulation on the Prevention of Conduct Abusing Administrative Powers to Eliminate or Restrict Competition.

[3] NDRC Anti-Price Monopoly Regulation, and NDRC Regulation on the Anti-Price Monopoly Administrative Enforcement Procedure.

SAIC's regulations follow publication of draft substantive regulations in April 2009 and May 2010 for public comment.[4] According to SAIC, its regulations are modeled on the antitrust regimes of other jurisdictions, including the United States, the European Union ("EU"), Germany, and Japan.[5] There are obvious parallels between SAIC's regulations and international practice but there are also differences, some of which are highlighted in this article. Memoranda of understanding and other agreements between SAIC and other regulators may serve to align SAIC's procedures and enforcement practice further with international practice.[6]

## III. MONOPOLY AGREEMENTS

Under the SAIC Monopoly Agreements Regulation, prohibited monopoly agreements include agreements, decisions, or concerted practices between companies that eliminate or restrict competition in China. However, the regulation does not set a materiality or appreciability threshold for anticompetitive effects nor does it emphasize enough the need to show actual or foreseeable harm to consumers. The regulation merely lists examples of commercial practices that are prohibited under the AML.

The SAIC Monopoly Agreements Regulation focuses on prohibiting restrictive horizontal agreements between competitors. There is no explicit mention of vertical agreements. This may not be indicative of a *laissez-faire* attitude towards vertical restraints.[7] A catch-all provision, which prohibits other monopoly agreements not expressly provided for under the regulation, is sufficiently broad to capture vertical agreements.[8] However, the provision offers little guidance on future enforcement practice. SAIC may have determined that vertical agreements generally do not raise concerns other than pricing issues for which NDRC is competent.[9]

In line with the AML, the SAIC Monopoly Agreements Regulation explains that a monopoly agreement can be oral or in writing, and that the concept is broad in scope and covers other concerted actions or tacit understandings between competitors.[10] In determining whether

[4] Unlike the other two substantive regulations, the SAIC Abuse of Administrative Powers Regulation was first published for comment in May 2010.

[5] *See*, *A representative from the SAIC answers questions in relation to three implementing regulations of the AML*, available at www.saic.gov.cn. As SAIC's representative also explains, SAIC considered the approaches of international organizations such as the OECD and solicited opinion widely, including from the EU and US enforcement authorities, academics in the antitrust and economics arena, international and domestic law firms, the National People's Congress, the State Council Legislative Affairs Office, the Supreme People's Court, MOFCOM, NDRC, major state-owned enterprises, privately-owned companies, foreign-invested companies, industry associations, and chambers of commerce.

[6] For example, on November 15, 2010, SAIC and the UK's Office of Fair Trading agreed a Memorandum of Understanding aimed at, *inter alia*, setting common competition standards on a range of competition regulation and enforcement action.

[7] Article 14 of the AML expressly prohibits restrictive vertical agreements unless covered by one of the broad exemptions under Article 15 of the AML. This includes agreements that generate efficiencies provided that consumers share the benefits of the agreement and competition is not significantly restricted in the relevant market as a result of the agreement.

[8] SAIC Monopoly Agreements Regulation, art. 8.

[9] Under the NDRC's parallel Anti-Price Monopoly Regulation, the fixing of resale prices and the setting of a minimum resale price are expressly prohibited, and NDRC has discretion to identify other vertical restraints. SAIC's previous draft regulation on monopoly agreements identified a number of non-price-related agreements that could be caught by the AML. For example, the 2009 draft regulation referred to vertical territorial restrictions and vertical exclusive dealing.

[10] SAIC Monopoly Agreements Regulation, art. 2.

companies have engaged in concerted practices, the provisions indicate that SAIC will look for evidence of parallel behavior as well as cooperation between the parties.[11] In addition, SAIC will also consider whether there are reasonable justifications for the parties' suspected coordinated behavior, such as market conditions. Although the guidance is welcome, the definition of concerted practice under the AML remains vague and could cover a company's rational and unilateral decision to act in the same way as a rival(s) in response to market forces. Other jurisdictions such as the EU and United States have developed precedents to determine when parallel conduct constitutes unlawful behavior.[12]

Prohibited activities under the SAIC Monopoly Agreements Regulation include: production or sales restrictions;[13] market sharing or customer allocation and allocation of raw materials procurement markets or suppliers; [14] restrictions on the development, purchase, investment, or use of new technologies, techniques, and equipment and acceptance of new technical standards;[15] and joint boycotts of customers or suppliers.[16]

Repeating the AML, anticompetitive practices organized, encouraged, or facilitated by industry associations are also prohibited. [17] Such practices include the formulation or promulgation of rules, decisions, notices, and standards. In recent months, enforcement activity against trade associations has intensified. [18] In the latest reported case involving a trade association, the Jiangsu Province Administration for Industry and Commerce published a decision to fine the Concrete Manufacturers Association of Lianyungang City for fixing market shares and market sharing among members contrary to the AML.[19]

## IV. ABUSE OF A DOMINANT POSITION

The SAIC Abuse of Dominance Regulation builds on the AML and defines a dominant market position as a market position where an undertaking has the ability to control price, quantity, and other trading terms such as quality, or to restrict or foreclose market entry.[20] Dominance is presumed where a company has a market share of 50 percent, and where two companies together hold two-thirds of the market, or three companies hold three-quarters of the market. The presumption does not apply to a company with a market share of less than 10 percent.[21]

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[11] *Id.*, art. 3.

[12] *See*, for example, Black, *Concerted Practices, Joint Action and Reliance*, [2003] 24 ECLR 219; Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parellism and Refusals to Deal*, 75 Harv. L. Rev. 655 (1962); and Baker, *Two Sherman Action Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory*, 39 Antitrust Bull. 143 (1993) for a discussion on concerted practices and joint action in the EU and United States.

[13] SAIC Monopoly Agreements Regulation, art. 4.

[14] *Id.*, art. 5.

[15] *Id.*, art. 6.

[16] *Id.*, art. 7.

[17] *Id.*, art. 9.

[18] NDRC has pursued most of the cases often under the Price Law and not the AML.

[19] *See*, http://www.js.xinhua.org/xin_wen_zhong_xin_/2011-01/21/content_21923072.htm, January 21, 2011.

[20] SAIC Abuse of Dominance Regulation, art. 3.

[21] *Id.*, art. 11.

In an improvement on earlier draft versions of the regulation, the focus is not entirely on market share analyses.[22] SAIC will also consider the competitive dynamics of the relevant market, the ability to control supply or purchasing markets, financial and technical strength, the extent to which businesses are dependent on the company, and market entry barriers. However, market share can be expected to play a prominent role as in the merger control context.[23]

Reliance on financial strength is unfortunate since a company's profitability is not, in itself, indicative of economic strength. Indeed, reduced profit margins or even losses for a time are not incompatible with a dominant position. Equally, large profits in a market may be compatible with a market where effective competition exists. The concept of financial strength also raises questions under the AML—is this relative or absolute strength? Is this a measure of financial resources or profitability? Does financial strength itself give rise to dominance? The SAIC Abuse of Dominance Regulation offers no guidance on these issues.

In terms of abusive practices, the SAIC Abuse of Dominance Regulation targets four types of conduct although the list is not exhaustive. The list includes refusal to deal (including denying access to essential facilities or reducing or delaying supply);[24] exclusive or restrictive dealing;[25] tying and imposing unreasonable terms;[26] and discrimination.[27] Significantly, the list does not include *per se* prohibitions suggesting that SAIC will adopt a rule of reason approach. However, the provisions do not emphasize enough the need to establish actual or foreseeable anticompetitive effects, namely harm to consumers.

The identified practices are broadly consistent with abusive behavior found in other jurisdictions. Nonetheless, certain practices such as restrictions on payment methods, which major jurisdictions do not normally regard as abusive, leave room for possible divergence with international practice. In addition, the envisioned essential facilities doctrine seems broader than in the EU or United States where dominant companies are not generally required to grant access unless such access is necessary for a rival to provide a new product or service, and not simply to operate effectively on the market, as the rules seem to imply. More generally, SAIC's rules do not adequately address the interface between intellectual property rights and the abuse of dominance provisions. SAIC is understood to be drafting separate rules regarding this.[28] In relation to tying, the regulation does not address some of the more difficult issues that regulators in the EU and

[22] *Id.*, art. 10.

[23] *See*, for example, MOFCOM's decisions in respectively *Pfizer/Wyeth*, September, 29 2009; *Panasonic/Sanyo*, October 30, 2009; and *Novartis/Alcon*, August 13, 2010. As enforcement authorities and courts in many jurisdictions have found, market share alone rarely suffices to establish dominance. In the EU, for example, the seminal *Hoffman-La Roche* judgment cautions that "[a] substantial market share as evidence of the existence of a dominant position is not a constant factor and its importance varies from market to market according to the structure of these markets, especially as far as production, supply and demand are concerned." *See*, Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, paragraph 40. This is echoed in other major jurisdictions.

[24] SAIC Abuse of Dominance Regulation, art. 4.

[25] *Id.*, art. 5.

[26] *Id.*, art. 6.

[27] *Id.*, art. 7.

[28] In January 2011, the Ministry of Industry and Information Technology published draft rules for public comment on Internet governance. The draft rules address a variety of issues, including unfair competition and consumer and data protection. It is unclear whether SAIC will rely on these rules to inform its enforcement of the AML with respect to new technologies or technologies covered by intellectual property rights.

United States have grappled with in recent years—such as the approach to technical tying and commercial bundling.

The onus is on the dominant company to justify suspected unlawful conduct but little guidance is given on what constitutes reasonable justification. The provisions merely explain that SAIC will consider whether the relevant conduct is based on normal business operations together with the conduct's impact on economic efficiency, social and public interests, and economic development.[29] There is no indication of whether conduct that is consistent with industry practice would constitute reasonable justification. The lack of specific guidance contrasts sharply with NDRC's rules on abuses of a dominant position, which offer examples of reasonable justifications—albeit in the case of price-related practices.[30]

Another area of possible divergence between the SAIC and NDRC substantive rules is the treatment of state-owned enterprises ("SOEs"). The NDRC regulations[31] expressly prohibit SOEs and companies with exclusive rights from engaging in practices that harm consumers, but the SAIC regulations do not. Although the rules are silent, SAIC's approach may reflect the perception that NDRC has a long enforcement tradition against SOEs—often under the Price Law. It remains to be seen to what extent SAIC will pursue SOEs under the AML.[32]

## V. ENFORCING SAIC'S REGULATIONS

### *A. Penalties and Leniency*

In keeping with earlier drafts and repeating the AML, the SAIC regulations set penalties for infringements, including fines ranging between 1 percent and 10 percent of a company's turnover from the previous year and confiscation of illegal gain.[33] Fines of up to RMB 500,000 can also be imposed in the case of an anticompetitive agreement that has yet to be implemented, and for infringements by trade associations. The regulations do not provide further clarity on how fines will be calculated. For example, fines are not expressly limited to the product market in which the anticompetitive conduct occurred. It is also unclear whether the turnover on the basis of which fines are calculated is limited to sales in China or is global. The fines imposed could thus potentially be significant.

The SAIC Monopoly Agreements Regulation further explains that the first company to report an anticompetitive agreement, provide material evidence, and cooperate fully with SAIC during its investigation is entitled to leniency.[34] Leniency is also available to subsequent

[29] SAIC Abuse of Dominance Regulation, art.8.

[30] For example, the promotion of new products for below-cost pricing, the availability of comparable alternatives for refusals to deal, and ensuring product quality or safety or protecting brand image for exclusive dealing via discounts.

[31] NDRC Anti-Price Monopoly Regulation, art. 4.

[32] The recent investigation by the Hubei price authority, under the AML, of tying the sale of table salt with washing powder by a branch of the Hubei Salt Industry Group illustrates NDRC's enforcement action against exploitative practices of SOEs or companies with exclusive rights that harm consumers. *See*, http://jjs.ndrc.gov.cn/gzdt/t20101115_380421.htm, November 15, 2010.

[33] SAIC Monopoly Agreements Regulation, art. 10; SAIC Abuse of Dominance Regulation, art. 14. Private action for damages is also available under the AML.

[34] SAIC Monopoly Agreements Regulation, art.12. SAIC may suspend its investigation if the company under investigation demonstrates that its conduct falls within one of the exemptions under Article 15 of the AML. SAIC may also suspend its investigation upon request. A company under investigation may apply for suspension by

applicants but at SAIC's sole discretion and will depend on the sequence of reporting, the importance of the information provided, relevant facts concerning the conclusion and implementation of the anticompetitive agreement, and the cooperation given during SAIC's investigation.[35] The lack of certainty and the unpredictability of the leniency regime could discourage potential whistle-blowers from coming forward.

### *B. Enforcement in Practice*

With two enforcement authorities issuing parallel rules on monopoly agreements and abuses of a dominant position, jurisdictional conflicts can be expected to arise. The distinction between non-price- and price-related conduct, which delineates SAIC/NDRC jurisdiction, will not always be easy to draw. In economic terms, there is no real bright-line between an agreement to limit output and an agreement to fix prices, just as a refusal to supply a product does not differ from supplying that product at an excessive price. SAIC's provisions, like the NDRC's rules, offer little guidance on which authority would lead an investigation if jurisdictional conflicts arise. This is unfortunate especially since cartels often raise non-price- and price-related issues.

SAIC, like NDRC, envisages delegating enforcement of the AML to local authorities but the approaches differ with regard to enforcement at local levels. SAIC's preference is to maintain greater control over enforcement proceedings and to delegate to local authorities on a case-by-case basis, while NDRC intends to delegate enforcement generally to pricing authorities at provincial levels and to grant them a high level of autonomy. SAIC's model has the benefit of guaranteeing a greater level of consistency in enforcement practice and decision-making. However, there is a risk that this more bureaucratic, inflexible approach will fail to make allowances for the particular nature of local conditions. The preference for a greater degree of direct involvement could also result in slower progress during investigations as well as potential backlogs.

Coordination between the two authorities will be important to ensure consistent application of the AML, including leniency applications. It is understood that SAIC and NDRC have adopted internal rules that address jurisdictional issues and coordination. It remains to be seen how these will apply in practice.

## VI. CONCLUSION

Thus far, China's enforcement practice under the AML has focused on merger control where MOFCOM has rapidly established itself as a major enforcement authority. In contrast, SAIC and NDRC have shown considerable restraint in enforcing the AML against anticompetitive conduct. The adoption of SAIC's regulations can be expected to spur investigations, and SAIC may no longer hesitate to impose fines or confiscate illegal gain.

SAIC's regulations are potentially far-reaching and, if enforced, may call into question certain commercial practices that have so far been permissible in China. However, the true scope and impact of these regulations are unlikely to be clear until enforcement intensifies. The regulations offer welcome guidance on SAIC's enforcement priorities but raise many questions

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submitting a statement of facts explaining the suspected anticompetitive conduct and its potential effects, together with commitments to address the identified effects within a specified period.

[35] Leniency is available to an unlimited number of leniency applicants rather than only three as appears to be the case under NDRC's leniency regime.

and leave SAIC with considerable discretion with respect to its enforcement of the AML. The potential challenge that lies ahead is how SAIC and NDRC will streamline decisions under the AML and coordinate their different approaches.