Antitrust Chronicle

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CHINA'S NEW DAWN OF ANTITRUST

CPI COMPETITION POLICY INTERNATIONAL

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LETTER FROM THE EDITOR

Dear Readers,

In his New Year speech on December 31, 2016, President Xi Jinping stated that "[f]or the Chinese people, the year of 2016 is not only outstanding but also unforgettable… We actively promoted the building of rule-of-law in this country, deepened the reform on the judicial system, enhanced judicial justice in all aspects, and maintained social fairness and justice." We could use President Xi's statement to summarize China's competition policy in 2016. Under the 13th Five-Year national development plan, and supply-side structural reform promoted by the current leadership, the enforcement of competition policy in China has been well-rounded and sophisticated, despite China's lack of experience compared to other jurisdictions such as the United States and the European Union.

With many new developments in legislation and enforcement of both China's Anti-Monopoly Law ("AML") and Hong Kong's Competition Ordinance, we are delighted to release our CPI Antitrust Chronicle issue for March 2017: **The Golden Era of Antitrust in China**.

This special China issue starts with an interview with Mr. Handong Zhang, Director General of the National Development and Reform Commission ("NDRC"). DG Zhang explains to us the Fair Competition Review System ("the System") as the milestone in the AML enforcement history. Given that the NDRC took the lead during the design and drafting of the System, DG Zhang shares with our readers his insights, some key points and implications of the policy, as well as challenges and opportunities.

Professor Yong Huang of University of International Business and Economics ("UIBE") and Dr. Baiding Wu of UC Berkley follow the same topic, and provide their opinions on some of the issues of China's Fair Competition, as well as possible solutions. Are they optimistic about the future of Fair Competition Review? Our readers will find out in their interesting article.

The relationship between Standard Essential Patents ("SEPs") and competition policy has always been challenging for legal and economics scholars. In recent years, there have been hot debates on this issue. Weilian Ding, Deputy Chief Judge of the Intellectual Property Tribunal of Shanghai High People's Court, applies game theory in SEP injunction applications and information disclosure. In this article, he proposes a novel and precise way to explain the incentive issues in this sophisticated legal phenomenon in SEP litigations.

Professor Ping Lin of Lingnan University, Hong Kong and Professor Tom Ross of University of British Columbia examine the first year enforcement of Hong Kong's Competition Ordinance ("CO"). Acknowledging that the CO has effective impact on certain important sectors in Hong Kong, the authors further provide an assessment of the complaints-driven approach undertaken by the HK Competition Commission.

In 2016, private litigation in China also gained attention from competition scholars. Professor John Jiong Gong of UIBE and I review the recent private litigation against Panasonic in Shanghai. We analyze vertical restrains and horizontal agreements in the manufacturer-distributor relationship from economic perspectives.

Three groups of excellent practitioners shed light on the enforcement actions taken by the three Chinese competition agencies in 2016. Susan Ning, Kate Peng, Sibo Gao and Ting Gong of King & Wood Malleson summarize the enforcement status of the NDRC. Michael Han, Andrew Skudder and David Boyle of Fangda examine royalty rebates in the *Tetra Pak* case ruled by the SAIC. John Yong Ren and Wesley Zhining Wang of T&D Associates lay out a big picture perspective of the merger reviews conducted by MOFCOM and provide policy implications from their observations.

We thank our contributors for their efforts and dedication to our March 2017 CPI Antitrust Chronicle, and hope you enjoy it.

Sincerely,

Vanessa Yanhua Zhang, Ph.D.
Global Economics Group and Market & Regulation Law Center, Renmin University

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China's Fair Competition Review: Introduction, Imperfections And Solutions

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In recent years, the issue of "fair competition review" has become a key priority for the Chinese Central Government in its consideration of competition policy and a hot topic in the circle of Chinese agencies, jurists and economists specialized in competition policy. China has attracted widespread attention since the promulgation of Opinion on Establishing a Fair Competition Review System during the Development of Market-oriented Systems ("Opinion") by China's State Council on June 1, 2016 and the successive implementation of the Opinion by China's local governments thereafter.

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By Judge Wenlian Ding

There is no doubt that the license fee of Standard Essential Patents ("SEPs") can be priced by a judge's ruling. On the one hand, such price determined by a judge's ruling is difficult to be as accurate and fair as market pricing, while on the other hand, pricing based on the judgment is difficult to be implemented. It is the main path to settle such disputes to facilitate a negotiation between SEP holder and enforcer through fair and effective procedures. The question is how to make the court's judicial process more conducive to facilitating both parties to sit at the negotiating table. This article conducts a game theory analysis on the injunction application and information disclosure in the negotiations over SEP license fees, and provides suggestions to improve the judicial process for SEP disputes.

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Since the enforcement of the Anti-Monopoly Law ("AML") in China, there have been several high-profile antitrust litigations involving vertical restraints in the manufacturer-distributor relationship. In China vertical restraints are also called vertical monopoly agreements in the context of the AML. In 2013, the Shanghai Higher Court set precedence of applying the "rule of reason" doctrine in the cases involving vertical monopoly agreements, as opposed to the more common "*per se* illegal" doctrine that is widely applied in situations of vertical monopoly agreements in China. This article addresses recent cases that blur the boundary between vertical and horizontal monopoly agreements in manufacturer-distributor relationships.

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By Susan Ning, Kate Peng, Sibo Gao and Ting Gong

Since the enactment of the Anti-monopoly Law ("AML") in 2008, China's AML enforcement has gained momentum, especially over the past three years. This development makes China one of the most important jurisdictions to which the companies need to pay close attention. 2016 was an intensive year for the NDRC. Looking back, the NDRC's work mainly focused on i) AML enforcement against monopoly behavior by undertakings, ii) AML enforcement against abuse of administrative power by government and the introduction of the fair competition review system; and iii) promulgation of six antitrust guidelines. In light of the NDRC's efforts in 2016, the authors present their speculation of the NDRC's enforcement priorities in year 2017 and the future.

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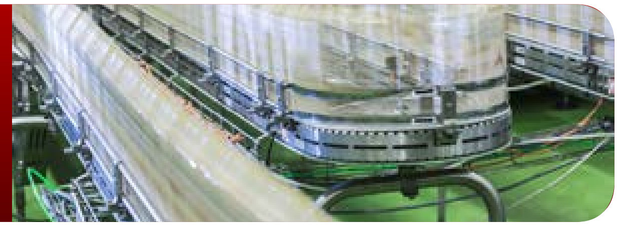

The *Tetra Pak* Case: Are Loyalty Rebates Treated Differently By The Chinese Antitrust Regulator?

By Michael Han, Andrew Skudder and David Boyle

In November 2016, the SAIC published its penalty decision against Tetra Pak. Following a thorough investigation, the SAIC imposed a fine of USD $97 million on Tetra Pak for abusing its dominant market position in the liquid food aseptic carton packaging industry. The SAIC's decision in relation to Tetra Pak's loyalty rebates scheme is noteworthy since it is the first time a Chinese antitrust enforcer has considered loyalty rebates offered by a dominant firm to be a violation of the AML. In this article, the authors focus on the SAIC's findings that Tetra Pak's loyalty rebates schemes amounted to an abuse of dominance and compare this to the approach taken by the European Commission in the *Intel* case.

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ANNOUNCEMENTS

REACHING OUT IN 2017

CPI wants to hear from you, our subscribers. In the coming months of 2017, we will be reaching out to members of our community for your feedback and ideas. Let us know what you want (or don't want) to see, at: antitrustchronicle@competitionpolicyinternational.com.

CPI ANTITRUST CHRONICLE MAY & JUNE 2017

As a reminder to potential authors, our topic for the May 2017 Antitrust Chronicle is **Antitrust and the Algorithm-Driven Economy**.

And looking ahead to June, we will turn our attention to **Index Funds, Institutional Investors and Antitrust**.

Contributions to the Antirust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited (follow bluebook style for footnotes) and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions for the May edition by April 20, 2017 to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, for the May and June issues, priority will be given to articles addressing the abovementioned topic. Co-authors are always welcome.

WHAT'S NEXT?

This section is dedicated to those who want to know what CPI is preparing for the next month. Spoiler alert!

We look forward to bringing our subscribers the April Antirust Chronicle (to be published in the second half of the month) entitled **At the Crossroads – IP and Antitrust**. This edition will be based in part on the LeadershIP Conference to be held in Washington, DC on March 27th where CPI will be among the cosponsers. LeadershIP 2017 is designed to address the global legal and economic policy issues at the intersection of IP and Antitrust that have been evolving rapidly, and their impact on international businesses.

INTERVIEW WITH MR. HANDONG ZHANG, DIRECTOR GENERAL OF THE NATIONAL DEVELOPMENT AND REFORM COMMISSION (NDRC) OF P.R. CHINA

BY VANESSA YANHUA ZHANG

Since the Anti-Monopoly Law ("AML") took effect in August 2008, agency enforcement has been an important area that attracts scholars and practitioners' attention. We are very honored to have an interview, conducted in January 2017, with Mr. Handong Zhang, Director General of the National Development and Reform Commission ("NDRC") of P.R. China. Below is the full interview.[1]

1. On June 14, 2016, the State Council officially issued the Opinion on Establishing Fair Competition Review Mechanism during the Development of the Market System ("the Opinion"), which marked the establishment of fair competition review mechanism in China. Introducing the fair competition review mechanism is a new milestone in China's competition policy enforcement history, which further promotes the construction and development of the market economy in China (in light of the eight-year anniversary since the Anti-Monopoly Law went into effect). Could you give some background to the historical background, the basic starting point and the final objective when the mechanism was designed?

China is in a historical phase of deepening reforms to the market economy on all fronts. As we make progress on reforms, a modern market system is taking shape, market mechanisms are playing an ever greater role, and the market competition environment is constantly improving. However, some local governmental agencies still keep protectionism and industry barriers in place. These practices have jeopardized our single market which promotes openness and orderly competition. They have distorted the allocation of market resources, dampened companies' passion to innovate and lowered the economy's overall efficiency. So establishing and improving a mechanism to guarantee fair competition and create a market environment for fair competition has become the important element in reforms to the economic system. The Third Plenary Session of the 18th Central Committee of the Communist Party of China clearly pointed out that the key issue in reforms to the economic system is to properly handle the relationship between the government and the market so that the market plays a decisive role in resource allocation and the government does a better job doing what it should do. It also confirmed that establishing a single market featuring openness and orderly competition is a precondition for the market to play a decisive role in resource allocation. This is the historical background for introducing the fair competition review mechanism, which is crucial to create and maintain a market environment for fair competition.

The core of the fair competition review mechanism is a requirement for policy-making authorities to enhance, *ex-ante*, as well as ongoing assessments, of their policies to prevent any policy from excluding or restricting market competition. The fair competition review mechanism intends to provide investors and operators with a policy environment that benefits fair competition and to constitute a nationwide single market featuring openness and orderly competition. This will cut institutional costs of transactions, promote market innovations and facilitate economic restructuring. As a result, the entire economy will run more efficiently, at last, benefiting consumers.

1 We are grateful to Madame Qing Li, Mr. Huowang Wang and Ms. Qun Xin for coordinating and facilitating this interview.

2. Could you explain the stipulations laid out by the Opinion and the way to implement the mechanism?

The Opinion includes comprehensive stipulations for establishing a fair competition review mechanism. These stipulations can be summarized as "**three combinations, four categories of criteria and four measures**."

Three combinations. (1) The combination of regulating new policies and screening existing ones. At the same time, regulating new policies is an urgent task. We should conduct fair competition reviews to comprehensively ensure that no new policies restrict competition. Meanwhile, we should move steadily to screening existing policies and, in accordance with the fair competition review standard, abolish those that hinder fair competition or harm the country's single market. (2) The combination of self-review by policy-making authorities, and scrutiny by the public and accountability. The Opinion puts forward self-reviews by policy-making authorities as the basic idea. In the process of formulating policies, they should perform rigorous self-reviews in accordance with the standards set in the fair competition review mechanism. Meanwhile, policies that have been reviewed and released should be open to public scrutiny. If any policy is found to have been released without undergoing a fair competition review, whoever has made it should be held strictly accountable. (3) The combination of principled prohibitions and exceptions. The Opinion stipulates that policies restricting competition should not be released or should be rectified to meet relevant requirements before being released. Meanwhile, in light of actual needs that arise from economic growth, the Opinion allows exceptions for policies that protect national security, the country's interests and public interests. If such policies restrict competition, they can be implemented as long as they comply with certain rules.

Four categories of criteria. The Opinion proposes 18 criteria for fair competition reviews in accordance with the requirements for building a nationwide single market featuring openness and orderly competition. These criteria fall into four categories: (1) Criteria for entering and exiting the market. Equitable entry and exit criteria should be set for all market players. (2) Criteria for the free flow of products and factors of production. The free flow of products and factors of production across the country should be facilitated so that a nationwide single market can take shape. (3) Criteria for influencing production and business costs. Production and business costs of any operator should not be illegally increased or decreased, since this harms fair competition. (4) Criteria for influencing production and business conduct. Each operator's right to operate independently should be protected, without any improper interventions.

Four measures. The Opinion provides four measures that ensure smooth and effective implementation of the mechanism: (1) Step-by-step implementation. The central government, provincial-level governments and their departments started implementation in June 2016. Since the start of 2017, the provincial-level governments, drawing on already accumulated experience, have been phasing in the fair competition review mechanism in their respective jurisdictions and offering guidelines for municipal and county governments and their departments in conducting reviews. (2) Regular assessments. Policies that have been reviewed and released should be regularly assessed in terms of their effectiveness and influence on market competition. Adjustments should be made based on assessment results. (3) Detailed rules. Detailed rules for implementation should be worked out to specify items to review and procedures to follow. This helps policy-making authorities with fair competition reviews. (4) Enhanced law enforcement. Anyone who abuses executive power to exclude or restrict competition should be timely investigated and punished, and such legal cases should be made public. This forces policy-making authorities into a position where they have to take fair competition reviews seriously.

3. In designing the fair competition mechanism, what considerations were given to China's fundamental realities?

(1) Criteria for fair competition reviews. With existing outstanding problems in mind, the Opinion proposes 18 criteria for fair competition reviews in accordance with the requirements for building a nationwide single market featuring openness and orderly competition. These criteria fall into four categories: (a) Criteria for entering and exiting the market. Equitable entry and exit criteria should be set for all market players; (b) Criteria for the free flow of products and factors of production. The free flow of products and factors of production across the country should be facilitated so that a nationwide single market can be taken form; (c) Criteria for influencing production and business costs. Production and business costs of any operator should not be illegally increased or decreased, since that harms fair competition; (d) Criteria for influencing conducts of production and business. Each operator's right to operate independently should be protected, without any improper interventions. The four categories of criteria define boundaries for the government participating in market activities. They mean a lot to the proper handling of the relationship between the government and the market and the prevention of the government from exerting undue influence on the market. Meanwhile, the Opinion has two miscellaneous provisions to ensure that government behavior is regulated to the largest possible extent: (1) unless there is a legal basis, no policy should be formulated that reduces the lawful rights of market players or increases their obligations; (2) no policy should be formulated that violates the Anti-Monopoly Law by excluding or restricting competition.

(2) Review models. The main review model specified by the Opinion is policy-making authorities conducting self-reviews, on the basic of comprehensive consideration of China's economic development phase, existing laws and regulations and China's executive system. In detail, there are a few reasons: (a) Such a model is compatible with China's existing laws and regulations as well as the country's executive system. According to the Anti-Monopoly Law, when executive power is abused to exclude or restrict competition, the anti-monopoly authority can make a suggestion after conducting an investigation. The superordinate authority of the violating party should request rectification based on the suggestion. This is compatible with policy-making authorities conducting self-reviews; (b) Policy-making authorities have a better understanding of policies' backgrounds, purposes and contents. Letting them conduct self-reviews can help strike a better balance between protecting market competition and achieving policy targets; (c) The process of policy-making authorities conducting self-reviews is also a process of advocating competition. This can constantly raise policy-making authorities' awareness of fair competition and change their mindsets, thereby getting them to protect fair competition without being pushed.

Meanwhile, the Opinion requires combining self-reviews and external scrutiny. Public scrutiny and law enforcement scrutiny should be enhanced to ensure that fair competition reviews are objective, impartial and effective. Public scrutiny means that, during reviews, policy-making authorities should seek opinions from all stakeholders or the public. Policies that have been reviewed and released should be made public. Law enforcement scrutiny means that more efforts should be made to investigate and punish the abuse of executive power to exclude or restrict competition. Such cases should be made public in time, forcing policy-making authorities to take fair competition reviews seriously.

The "self-reviews plus external scrutiny" model is currently the most feasible way. Of course, as the Opinion points out, the fair competition review mechanism is a long-term, systematic and complex program. We need to think about the current phase and, at the same time, look to the future. We need to constantly sum up experiences and effectiveness so that we can keep honing the mechanism. When conditions are ripe, we can organize third-party assessments or set up an independent review mechanism.

4. The Opinion has been released for half a year. Could you offer a few examples or share with us some experience in the process of implementing the fair competition review mechanism across the country and across relevant departments?

As a whole, the fair competition review mechanism is being steadily implemented. Since the Opinion was issued, the NDRC has taken diverse measures to push for the implementation of the mechanism. (1) It has organized dedicated press conferences, workshops and training sessions to publicize and interpret the policy. (2) It has taken the initiative to set up an internal working procedure for fair competition reviews, which ensures that fair competition reviews are mandatory before policies can be released. In strict accordance with the requirements, all bureaus under the NDRC are conducting fair competition reviews on policies that are in the pipeline. (3) It has pushed for the establishment of a joint conference system that involves multiple governmental departments. This is aimed at good coordination in the implementation of the mechanism. At the moment, all regions and governmental agencies are working to build their own review procedures. Twenty-three provincial-level regions, including Guangdong, Jiangsu, Sichuan, Chongqing, Hunan, Hebei, Fujian, Liaoning, Ningxia, Beijing, Guizhou, Shaanxi, Hubei, Gansu, Guangxi, Zhejiang, Heilongjiang, Shanxi, Inner Mongolia, Jilin, Tianjin, Shanghai and Anhui have released detailed opinions for the implementation of the fair competition review mechanism. The NDRC, the Ministry of Industry and Information Technology, the Ministry of Housing and Urban-Rural Development and the Ministry of Commerce have set up the dedicated review procedures. Most other governmental agencies have incorporated fair competition reviews into existing legality reviews.

5. What do you think of the implementation of the fair competition review mechanism in the future? What challenges and opportunities are there?

China is pressing ahead with supply-side structural reforms. The key to supply-side structural reforms is to give full play to the market's decisive role in resource allocation. The market system needs to be improved further so that distortions caused by the overuse of executive power in allocating factors of production can be corrected. The fair competition review mechanism has a crucial part to play in supply-side structural reforms. So I believe that the mechanism will be properly implemented at all levels of executive authorities. That said, it takes time for the mechanism to yield the desired effects. It is a gradual process. The NDRC will keep working to intensify coordination with relevant governmental agencies and provide more guidance for local governments as it supervises them. It will also formulate detailed rules for the implementation of the mechanism and take a harder line on the abuse of executive power to exclude or restrict competition. All this will help implement the fair competition review mechanism effectively.

CHINA'S FAIR COMPETITION REVIEW: INTRODUCTION, IMPERFECTIONS AND SOLUTIONS

BY YONG HUANG & BAIDING WU[1]

I. INTRODUCTION

In recent years, the issue of "fair competition review" has become a key priority for the Chinese Central Government in its consideration of competition policy and a hot topic in the circle of Chinese agencies, jurists and economists specialized in competition policy.[2] China has attracted widespread attention since the promulgation of the *Opinion on Establishing a Fair Competition Review System during the Development of Market-oriented Systems* ("Opinion") by China's State Council on June 1, 2016[3] and the successive implementation of the Opinion by China's local governments thereafter.[4]

The fair competition review, according to the Opinion, is a mechanism enforced by the policy-making organs to review whether the regulations and policy measures involving market entry, industrial development, foreign investment attraction, tendering and bidding, government procurement and business code of conduct, fall into one of four prohibited categories.[5] The

1 Yong Huang is the director of the Competition Law Center and Professor of Law at the University of International Business and Economics ("UIBE"), Beijing 100029, China. Baiding Wu is a Ph.D. candidate at UIBE School of Law, Beijing 100029, China. This article presents the opinions of the authors and does not represent any institution.

2 Since the beginning of 2015, the Central Committee of the Communist Party of China ("CCCP") and China's State Council have issued several significant notices, statements and opinions, laying a solid basis for China's fair competition review and later the Opinion mentioned hereinafter. Many Chinese scholars have shown their support for this review. See, Xiaoye Wang, *Promoting the Fair Competition Assessment to Restrain Administrative Monopoly*, 1 Competition Law and Policy Review 3 (2016).

3 See: http://www.gov.cn/zhengce/content/2016-06/14/content_5082066.htm.

4 Jiangsu province took the lead by its promulgation of the *Implementation Opinion of Fair Competition Review*, which was followed by Beijing, Ningxia, Hunan, Shanxi and Guizhou with similar local regulations. See: http://www.js.xinhuanet.com/2016-08/26/c_1119460391.htm.

5 The four standards in the Opinion are: (a) standards on market entry and exit; (b) standards on the free movement of goods and production factors; (c) standards that affect production and operating costs and (d) standards that affect activities of production and

competition agencies and the Legislative Affairs Office of China's State Council shall assist these departments with the implementation of the review.

It is impossible for China to establish a fair competition review system without imperfection at the outset. Therefore, a review of its historical background seems necessary in order to achieve a better understanding of its evolution, imperfections and solutions to such imperfection.

II. HISTORICAL BACKGROUND

Before 1993, China had been a centrally planned economy without necessary and due stress on the role of the market economy regime. That situation has been shifted to a huge extent since 1993 when China was determined to establish a socialist market economy regime. Since then, the Chinese central government has tried to reshape the relationship between government and markets by means of deregulation, decentralization, adoption of the rule of law and reform of state-owned enterprises.

However, this process has moved back and forth because of China's heavy reliance on industrial policy by governmental agencies, the intertwined sector interests and widespread local protectionism in China, which has resulted in "a larger government and a smaller market." This reliance, interconnectivity and protectionism can be seen from, and have been proven by, the fact that China's State Council announced its four trillion RMB market-rescue plan in 2008, hoping to address the international financial crisis and drive its double-digit annual GDP growth. However, it has been known to the public for its unsatisfactory results and side effects up to the present.[6]

In that same year, China adopted its Anti-Monopoly Law ("AML"), which has also attracted wide attention. Many people have attached great hopes to its possible role in pushing forward the above process, but it had turned out that it was less admirable in early years.[7]

Many agencies and researchers specialized in competition policy have agreed that one of the main reasons for such less admirable result in China is her lack of competition policy, which is relatively weak in comparison with the more influential industrial policies.[8] Since the latter is centered on short-term economic performance and administrative approach, it is inevitable to bring about some drawbacks, which have indeed hampered China's current economic reform in the long run.[9]

These agencies and researchers have also acknowledged the limits of the AML in terms of restraining the expanded industrial policy. As a result, they advocate that the Chinese central government should take more measures in this regard and their proposals have been accepted in the end. In November 2013, China made an ambitious decision to establish a better market economy regime, with a focus on the safeguarding of a fair competition environment, which has been regarded as an official will of less government intervention and early official thoughts about the would-be fair competition review system in China.

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business operations.

6 The State Council carried out 10 measures to expand domestic consumption demands and boost economic recovery at the end of 2008. See: http://news.xinhuanet.com/fortune/2008-11/09/content_10331109.htm.

7 Xiaoye Wang, *Anti-Monopoly Law – the Milestone in China's Economic Reform*, See: http://www.iolaw.org.cn/showArticle.aspx?id=2154.

8 Competition Policy first appears in Article 9 of the AML, which reads, "the State Council established the Anti-Monopoly Commission, which…fulfills the responsibilities, including researching and drafting competition policy…"

9 Mr. Jinglian Wu, a prominent economist, pointed out that, "Our industrial policy… chooses to support some industries and enterprises and limit others. This policy is obviously anticompetitive and exists in almost all economic sectors in China." See: http://www.icc-ndrc.org.cn/Detail.aspx?newsId=5926&TId=99.

Meanwhile, since its accession to the WTO, China has shouldered a number of international obligations which call for modifications of its relevant domestic economic and trade policies and laws which were incompatibility with WTO law.[10] The requirement of compatibility has enhanced competition among various WTO members due to global economic integration. It has also pushed the convergence of domestic laws and rules, which requires, and is featured by, a "rule of law" government, more property protection, less market intervention and much fairer market competition. China has no reason to be an exception in this regard.

Therefore, it is necessary for China to establish the fair competition review system in order to meet the domestic demand for sustainable economic growth, faced with international pressure and to fulfill its international obligations, and make timely responses to the calling of agencies, jurists and economists engaged in competition policy. This is a major step forward and reflects the rising role of competition policy in China's public policies. Nevertheless, the implementation of this review has to overcome several challenges.

III. IMPERFECTIONS IN THE IMPLEMENTATION OF CHINA'S FAIR COMPETITION REVIEW

A. Cognitive Imperfection

Concept is the basis for, and has external and internal influence on, deeds. Therefore, the first imperfection in China's competition policy should stand at the conceptual level. By concept, it refers to the cognizable limitations of competition policy by many policymakers in China.

Although the scope of competition policy varies in different jurisdictions, it at least includes competition advocacy and competition law enforcement. The fair competition review system is the main component of China's competition advocacy. To that extent, it is safe to say that China's competition policy is basically complete.

However, the formulation of competition policy doesn't mean that it will naturally be one of China's basic economic policies. Many policymakers in China's central and local governments have an incorrect understanding of competition policy, which can be proven from two aspects. On one hand, policymakers have heavily relied on industrial policy to boost the economy instead of building a fair competition environment. For example, when the central government supported the photovoltaic industry,[11] some provinces assisted local firms in this industry through local industrial policies, which constituted discriminative measures against non-local firms in many ways.[12]

On the other hand, the Chinese government or authorities sometimes violate the AML without realization of its illegitimacy. In 2016, China's State Administration for Industry and Commerce ("SAIC") authorized its Anhui branch to investigate a cartel, which was organized by the Hefei Central Sub-branch of the People's Bank of China. This Sub-branch invited three firms, which sold payment ciphers, and 20 financial institutions in Anhui province, to attend the bidder's conference. It was at the meeting that, according to the arrangement and notification by the Sub-branch, the participants reached an agreement on the payment ciphers' price and type,

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10 The former director of the Department of Treaties and Law, Ministry of Commerce ("MOFCOM") mentioned that, "the rules of WTO have played a basic role in the development of China's foreign trade. The accession to WTO has not only brought us legal improvements…" See Xiaojie Lv ed., *Ten Year's Accession to WTO and the Rule of Law in China*, People's Publishing House, 2011.

11 China's State Council once stressed that, "[the governments shall] treat distinct photovoltaic enterprises differently, primarily support major enterprises which have advanced technology and market competitiveness and expel interior enterprises." See: http://www.gov.cn/zwgk/2013-07/15/content_2447814.htm.

12 For example, the Department of Energy in Jiangxi Province only provided provincial subsidy to the programs that used the photovoltaic products from its province. See: http://nyj.jxdpc.gov.cn/filePub/201604/W020160426577772697700.pdf. However, such discrimination against non-local firms is prohibited by China's National Energy Administration. See: http://zfxxgk.nea.gov.cn/auto87/201601/t20160114_2096.htm. This shows that even if the Chinese central government makes an adjustment of its policy, local governments could still carry out anticompetitive policies based on their interests.

market allocation plan and distribution measures. After the meeting, the Sub-branch assigned these three firms to deal with certain financial institutions respectively on the condition that they should not make contact or transactions with the clients of any other side. Undoubtedly, this is one typical case of cartels arranged by government departments.[13]

B. Contradiction Related to Regional Gap, Official Performance and Review Implementation

The second imperfection arises from the contradiction between and among the uneven regional economic development and local officials' pursuit of political achievements and their weights and influences on the implementation of the fair competition review system. Since China launched its reform and opening-up in 1978,[14] its unbalanced regional development policies have contributed to the huge economic success of coastal areas.[15] However, it has also resulted in side-effects such as huge development gaps between these regions and the rest of the country. Although the Chinese central government has begun to employ a coordinated development strategy for the eastern, central and western regions since 1991, the gaps have remained to the present. Therefore, different regions may have different attitudes toward the implementation of the fair competition review system because of their distinct motivations, resources and approaches.

First, the developed regions usually have a relatively mature market development, due to which governments therein have more inclination to embrace market mechanism and restrict their powers. Under such circumstances, the main motivation to implement such a system is to safeguard fair competition, which is in line with the Opinion.[16] However, the underdeveloped regions usually have a relatively low marketization, due to which governments therein have more inclination to intervene in markets. Under such circumstances, those governments have no, or less, motivation to conduct fair competition because such a system is incompatible with their habitual approaches.

Second, the developed regions usually have a number of relatively high-level policymakers and enforcement personnel involved in competition law, whose expertise can be given full play to the implementation of such a system. In contrast, there may be few human resources for the underdeveloped regions, and it is more difficult for them to take advantage of their expertise because of the lack of motivation of their regional governments to implement such a system.

Last but not least, developed regions attach more importance to the rule of law and property rights protection, and as a result, they are more likely to include the review system in their regional legal systems and make it long-term and systematically binding on their government powers. In contrast, the underdeveloped regions may put aside such a system because of their undue reliance on administrative policies and orders in their governance, and there may be a higher possibility of putting aside such a system in the event of a combination of the foresaid reasons.

In addition, there may be a conflict between the local officials' pursuit of short-term political achievements and their implementation of such a system.[17] The former means that they may use government power to intervene in the regional economy in a more

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13 The Competition Law Enforcement Announcement No. 9 of SAIC. See: http://www.saic.gov.cn/zwgk/gggs/jzzf/201611/t20161104_172076.html.

14 China's Reform and Opening-up has been a long-term national policy since Xiaoping Deng initiated it in 1978, aiming at, among other things, shifting China's centrally-planned economy to the market-driven one, promoting international trade and attracting foreign capitals and technologies to boost domestic development. This policy has, to a great extent, led to China's economic success and political changes since 1978. See: http://news.xinhuanet.com/theory/2008-12/05/content_10458896.htm.

15 See, Houkai Wei, *The Economic Transformation within the Past 30 Years since the Reform and Opening-up*, 5 Economic Perspectives 9 (2008).

16 The Opinion pointed out that, "Establishing a fair competition review system, and preventing excessive and inappropriate government intervention in the market are conducive to ensuring resources are allocated in a way that maximizes benefits and optimizes efficiency according to market rules, market prices and market competition."

17 See, Steven Cheung put forward the concept of "county economy" in his work, *The Economic System of China*, that the inter-province competition is the main reason for China's economic miracle in the 1980s. That inter-province competition is an example in this regard. However, many defects can be

active way so that the respective regional or personnel benefits may be maximized in a short period. However, such practices may not only hamper the healthy development of a market economy, but also runs contrary to competition policy in terms of safeguarding fair competition and realizing a long-term healthy economic development, and the system may come to naught in the end.

C. Conflict Between Reform and Review

The Chinese central authorities initiated the supply-side structural reform in 2016 in order to alleviate the contradictions on the supply side and stimulate China's economic growth. This reform is featured by its cutting industrial capacity, destocking, de-leveraging, lowering corporate costs and improving weak links.[18] Cutting industrial capacity mainly refers to the elimination of overcapacity in the field of iron and steel and the coal industry which have been featured by their low profits and high pollution. Although it has been repeatedly stressed that the market's key role should be played, there have still been inclinations in respective regional governments to achieve de-capacity targets through administrative orders from their policy orientation of "adhering to more Merger and Acquisition and re-organization than bankruptcy and liquidation" and their stresses on the policy of "good re-location of employees and bottom social security."[19]

There are two questions involved in the foresaid de-capacity. The first is the conflict between market economy disciplines and administrative intervention. In a market economy, those enterprises with low profits and high pollution are eliminated because of market competition and strict environmental protection laws. Governmental intervention is in violation of competition policy because governmental behavior should "restrict competition to the minimization" according to such policy and the fair competition review system.[20] Furthermore, there is no sustainability for de-capacity dominated by administrative organs from the perspective of effects. The second is that priority should be given to relocation or reemployment for the benefits of employees. De-capacity dominated by government will inevitably result in questions of relocation and reemployment. Plans for such relocations have been formulated by many regional governments, which have increased the cost or burden of public finance in essence.[21] However, the re-location may not be a question for government if such de-capacity is realized or completed by bankruptcy or reorganization under the spontaneous market influence. What the government should take into account is how to further the reemployment and reduce employment measures taken by enterprises which are against competition.[22] Although reemployment falls into the category of other public policies, it can still promote the competition in the human resources market, whereas measures adopted by enterprises against competition obviously fall into the category of competition policy. The simultaneous implementation of these two polices will be conducive to the enlargement of the human resources market and the increase of internal market competition. Therefore, the fair competition system should be applied to the consideration of the supply-side structural reform dominated by the government with an intention of de-capacity.[23]

attributed to such competition. For example, local officials may attach importance to short-term economic effects which may hamper market competition. See, Steven Cheung, *The Economic System of China,* CITIC Publishing Group, 2012.

18 De-capacity aims at the dissolution of surplus capacity, destocking focuses on the reduction of inventory of commodity house, de-leveraging refers to the decrease of leverage existed in financial system and used by enterprises, lowering corporate costs point at the reduction of systematic cost in transaction and unreasonable tax and fees borne by enterprises, and improving weak links requires improvement in poverty alleviation, new industry cultivation, service industry promotion, infrastructure development, ecologic governance, etc. See: http://news.xinhuanet.com/fortune/2016-05/27/c_129021077.htm.

19 See: http://politics.people.com.cn/n1/2016/0104/c1001-28006577-2.html.

20 See Yong Huang, *The Competition Policy in the Supply-side Structural Reform*, 1 Price Theory and Practice 21 (2016).

21 In the *Administrative Measures for Special Rewards and Subsidies for Structural Adjustments of Industrial Enterprises* issued by the Ministry of Finance, the central public finance has arranged 100 billion RMB to support the overcapacity reduction by local governments and central SOEs. It will allocate 24 billion RMB to the resettlement of employees. See: http://jjs.mof.gov.cn/zhengwuxinxi/zhengcefagui/201605/P020160519546386062558.pdf.

22 The Antitrust Guideline for Human Resource Professionals that published by FTC and DOJ, prohibits professionals to commit anticompetitive employment conducts. See: https://www.justice.gov/atr/file/903511/download.

23 Jiangping Wang, SAIC Deputy General Director, believes that the precondition for the supply-side structural reform is a healthy market regime and it depends on the basic role of competition policy." *See*, Jiangping Wang, *On the Basic Role of Competition Policy in the Supply-side Structural Reform*, 11 Administration Reform 12, 2016.

D. Lack of Independent Third Party for Fair Competition Review

The Opinion stipulates that:

> Policy-making Organs shall, during the policy-making process, conduct rigorous self-review pursuant to review standards. Policies that are considered as will not exclude or restrain competition upon review may be implemented, while those that will exclude or restrain competition shall not be promulgated or shall be promulgated only after being adjusted to meet relevant requirements. Policies that have not been subject to fair competition review may not be introduced.

Furthermore, the Opinion clearly provides that "they are encouraged to entrust third parties to carry out assessment." However, there are still many problems for such self-review.

First, there are huge differences between different regions and authorities in terms of self-review dynamics. Second, the organs in charge of policy formulation or competition policy should directly annul those policies and measures, namely, the four kinds and 18 types of policies and measures provided for in the Opinion which is obviously formulated to exclude or restrict competition effects.[24] However, there should be a complex economic consideration of those policies and measures without such obvious effects. Assessment conducted by a third party is a plausible way because the authorities in charge of policy formulation lack experience in complex economic analysis in general. At present, China lacks a professional and independent third party economics assessment institution, and as a result, there may be a higher possibility from the current situation that such authorities are more likely to approve such policies and measures with dim effect against competition. That is to say, there may be a higher false negative in governmental policies and measures against competition.[25]

E. Lack of Due Process for Fair Competition Review

The fifth problem relates to the lack of due process. The Opinion provides that "Policy-making Organs shall listen to the opinions of interested parties, or solicit public comments. After relevant policy measures are promulgated, they shall be disclosed to the public pursuant to *the Regulations of the People's Republic of China on Government Information Disclosure*." Despite this, the Opinion itself can't be sufficient to that end. It is extremely difficult to have effective monitoring from the outside if there is no open and due procedure for the review process. For example, after the Beijing Municipal Commission of Transportation published the *Rules for the Administration of Network-based Reservation Taxi Business and Service* in 2016,[26] "one lawyer wrote to the Commission to inquire whether the Rules had gone through the procedure of fair competition review. The Commission explained that principles for the review were whether the Rules were formulated according to law because administration by law was a top requirement and it had no contents of excluding or restraining competition.[27] However, there are still controversies about whether the sole access to the drivers with local household registration and to the cars with local automobile registration is against the Opinion. The public had no other way to know and monitor the review standard and process because no review procedure was released by the Commission.

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24 Id 5.

25 U.S. Judge Frank Easterbrook analyzed the false positive and false negative in antitrust enforcement. If we borrow this to think about public anticompetitive policies and measures, we shall maximally eliminate them, which embrace false positive wrongs. See, Frank H. Easterbrook, *Limits of Antitrust*, 63 Texas Law Review 1, 1984.

26 See: http://www.bjysj.gov.cn/xxgk/ggl/201612/t20161221_165385.html.

27 See: http://www.legaldaily.com.cn/index/content/2017-01/13/content_6955611.htm?node=20908.

F. No Opportunity for China's People's Congresses to Review Budget Considerations

The final institutional challenge is the deficiency of fair competition review in the budgetary considerations by the Chinese central and local people's congresses. The funds for China's numerous industrial policies mainly come from the annual budgets approved by the people's congresses. The new Chinese Budget Law, which was enacted in 2014, adopted multiple standards for budget considerations, such as the legality and reasonableness of budget arrangements and debts, and appropriateness of budget arrangements for the major expenditures and investment projects.[28] However, it has no provision on whether budget arrangement may exclude or restrain market competition,[29] not to mention the supervision of budget implementation from the perspective of fair competition review.[30]

It is almost impossible for Chinese People's Congresses at all levels to cancel or modify the industrial policy arrangements because of short periods for their consideration of draft budgets, numerous projects involved and financial complexity. The lack of fair competition review in budget considerations and supervision will definitely increase the *ex-post* costs and difficulties to correct the anticompetitive policies. What's more, regardless of being required by the Opinion, it may be difficult for, and there may be no jurisprudential basis for, authorities in charge of industry policy formulation to conduct self-review of "existing policies" and "incremental policies." On one hand, those authorities may resist the self-review by exploitation of "existing policies" review under the pretext that the current policies have been approved according to legal procedure; on other hand, those authorities may take a negative attitude toward the implementation of the Opinion against their reviews of "incremental policies" on the grounds that such reviews have not been provided for in the Budget Law and its relevant rules, and that they have no statutory obligation to abide as a result.

V. SOLUTION TO PERFECTING FAIR COMPEITION REVIEW SYSTEM IN CHINA

Although there have been so many imperfections in terms of the Chinese fair competition review system, there are still plausible solutions to such imperfections from different perspectives.

First, China should advance the status of its competition policy. Establishing the fair competition review and enforcing the AML are the initial steps to reinforce Chinese nascent competition policy. Predictably, China has to walk back and forward before its competition policy finally substitutes the industrial policy and becomes one of its fundamental economic policies.

To achieve this target, the Chinese competition policy community should try to persuade key policymakers, state-owned enterprises, private firms and the public to realize the advantages of competition policy and disadvantages of industrial policy, and share the view with them that competition policy needs to play a central role in the Chinese market economy. Of course, it will take a long time and patience to reach a consensus, which calls for the joint efforts of the Chinese courts, agencies, jurists and economists specialized in competition policy.

Second, China may introduce fair competition review into the system for assessment of local officials' political achievements. Regional leaders and officials may harm the competition policies beyond their levels for local protectionism or other reasons because the local developments have bigger and direct influence on their career promotion in comparison with competition policies above their levels. Therefore, China may make an improvement in its system for assessment and promotion of local officials by introduction of a competition policy record in order to have a better and leveled development with less unnecessary competitive construction and more necessary fair competition.

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28 See: http://www.npc.gov.cn/wxzl/gongbao/2014-11/02/content_1892137.htm.

29 See Article 48 of the *Budget Law of the People's Republic of China*. There is no provision requiring consideration from the perspective of competition policy.

30 See Chapter 9 (Supervision) of the Budget Law of PRC. http://www.npc.gov.cn/wxzl/gongbao/2014-11/02/content_1892137.htm.

Third, China may reform the current supply-side structural reform by using competition policy. The policy preference of the supply-side reform to administrative order has been costly and probably unsustainable. This approach is nothing new, but an old-fashioned and customary repetitive construction. Market-driven reform, as claimed by itself, shall come into play. However, the shift from the government-led track to the market-driven route would be much tougher and more sophisticated than anyone could imagine. As a practical matter, it would be an operational attempt to put this reform under competition policy and focus on the fair competition review of its stimulus measures, such as the financial rewards to local governments and resettlement arrangements.[31]

Fourth, China should make systematic legislation of fair competition review. At present, the Opinion has been a general public policy and many provisions need to be formulated. Therefore, China's State Council should, within a reasonable period, draft and enact the *Rules for the Implementation of the Fair Competition Review* according to law. The Rules should include the authorities, criteria, due process and liabilities in terms of such review. In particular, with regard to the review of "existing policies" and "incremental policies," the Rules should establish competition agencies and governmental legal authorities as review authorities and the policymaking authorities as supporting ones. Additionally, the review procedure has to be open to the public and adopt hearing procedures.

Fifth, China should push for coordination between its fair competition review and budget laws. It is necessary to review the industrial policy arrangements when drafting, approving and implementing budgets. This requirement should be a part of the Budget Law and local Regulations on supervision over budgets. The Beijing Municipality took a lead in this regard. In January 2017, Beijing's Department of Finance, after hearing the advice from the members of the Finance and Economy Committee of Beijing Municipal People's Congress, amended its *Report on the Budget Implementation in 2016 and Budget Draft in 2017* to Beijing Municipal People's Congress. A clause was added in the Report which provides that "when making finance policies in support of industrial development and government procurement, the government and its departments shall implement fair competition review to regulate their conducts."[32] But this initiative has to be pushed harder and further by merging this statement into the *Regulations on Supervision over Budgets of Beijing Municipality,* which is under modification.

Sixth, China should promulgate its *Rules for the Implementation of Fair Competition Policy Review*. Currently, there are only 18 types of obviously anticompetitive policies under the Opinion. However, more in-depth economic analysis is vital for the assessment of the uncertain restricted policies. In fact, it is an optimal choice to enact the Rules. By learning from the competition assessment toolkit of the OECD,[33] the Rules, along with economic analysis, can be utilized by the review bodies to evaluate different industries. On the basis of these review results, the authorities could gradually clear the "existing policies." As a law of great significance with a would-be basic economic policy for China, the drafting of such Rules should be opened to the public and there should be full consideration of the opinions from practical, academic and the social experts. The task should be assigned to the Competition Commission or the three central competition agencies. Although China's State Council has established an *Inter-Ministerial Joint Meeting for the Fair Competition Review*, it is difficult to operate and coordinate because it consists of 28 ministries and commissions.[34] Under this framework, the three competition agencies and the Legislative Affairs Office, which are members of the Meeting, are expected to play leading roles.

Lastly, China should strengthen the public and private AML enforcement to public anticompetitive policies. Some provinces

31 Jiangping Wang, the Deputy Director General of SAIC stated that, "the Supply-side Structural Reform shall depend on a healthy market system and the fundamental role of competition policy." Jiangping Wang, *Strengthening the Fundamental Role of Competition Policy in the Supply-side Structural Reform*, 11 Administration Reform 12 (2016).

32 See: http://www.bjrd.gov.cn/zdgz/zyfb/bg/201702/t20170206_170507.html.

33 About the principle, guideline and operation manual of the OECD's competition assessment toolkit, see: https://www.oecd.org/competition/assessment-toolkit.htm.

34 The full list of departments and commissions, see: http://www.gov.cn/zhengce/content/2017-01/24/content_5162929.htm.

and municipalities have promulgated their follow-up versions of the Opinion.[35] But they share a common flaw – similarity of content with the Opinion, and lack of thoughtful and enforceable plans. Frankly speaking, this review still stays in a vacuum. The local implementations of the review may be worse if motivations, resources and approaches of self-review are taken into consideration.

The 18 prohibited policies provided for in the Opinion could be a part of the AML, which is also hostile to the abuse of administrative power to eliminate or restrict competition. Now that policymaking authorities seem to be reluctant to enforce the Opinion, the competition agencies could do more according to the authorization of the AML.[36]

The implementation of this review also depends on the courts. The rulings against the anticompetitive policies, which would be used by corporations affected by them, could be another powerful external restraint to the policymakers and in turn force their self-review.[37]

VI. CONCLUSION

The enactment of China's fair competition review system is a major step toward the strengthening of its competition policy. However, implementation of the system has to overcome many difficult institutional, legal and systematical obstacles in the long run, such as the cognizable limitations of competition policy by many policymakers, the uneven local economic development and officials' pursuit of political achievements, the current administrative supply-side structural reform, the absence of independent third party assessment and the inadequate due process. To better counter these obstacles, practical efforts have to be made, including reinforcing the understanding of competition policy, adopting the fair competition review progress into officials' political achievements' assessment, navigating the supply-side structural reform by the competition policy, legalizing the fair competition review, connecting the fair competition review and the budget laws, drafting the *Rules for the Implementation of Fair Competition Policy Review* and strengthening AML enforcement forces as well.

35 As previously stated, Jiangsu, Beijing, Ningxia, Hunan, Shanxi and Guizhou are among the earliest provinces and municipalities to promulgate their *Implementation Opinion of Fair Competition Review*. Id 4.

36 The competition agencies have increasing experience in investigating the anticompetitive conducts of public enterprises. For example, NDRC stated that it would pay special attention to the abuse of dominance in public facilities. See: http://www.ndrc.gov.cn/xwzx/xwfb/201607/t20160712_811004.html. SAIC and its local branches investigated 1,267 anticompetitive cases in certain sectors, such as water supply, electricity supply, natural gas supply and public transportation in 2016. See: http://www.gov.cn/xinwen/2017-01/12/content_5159120.htm.

37 See: Yong Huang, Baiding Wu and Zhanjiang Zhang, *The Implementation of the Fair Competition Review from the Perspective of Competition Policy*, 4 Price Theory and Practice 31 (2016).

GAME THEORY ANALYSIS OF SEP INJUNCTION APPLICATION AND INFORMATION DISCLOSURE

BY WENLIAN DING[1]

I. INTRODUCTION

There is no doubt that the license fees of Standard Essential Patents ("SEPs") can be priced by the judge's judgment, as in *Huawei v. IDC* and *Microsoft v. Motorola Mobility*. On the one hand, it is difficult to get such pricing, determined by judicial adjudication, to be as accurate and fair as market pricing. While on the other hand, pricing based on the judgment is difficult implement.[2] What's more, it consumes a considerable amount of judicial resources, so it shall not and will not be a mainstream way to settle disputes over SEP license fees. On the contrary, the main path to settle such disputes is to facilitate a negotiation between SEP holder and enforcer through fair and effective procedures. At present, the question is how to make the court's judicial process more conducive to facilitating both parties to sit at the negotiating table. This article will conduct a brief game theory analysis on the injunction application and information disclosure in the negotiations over SEP license fees, and provide suggestions to improve the judicial process for SEP disputes.

II. FACTORS THAT RESTRICT NEGOTIATION: INJUNCTION APPLICATION AND INFORMATION DISCLOSURE

Taking into consideration contracting costs and business reputation, the SEP holder and the enforcer can reach an agreement on most business negotia-

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1 Deputy Chief Judge of Intellectual Property Tribunal of Shanghai High People's Court. The author would like to thank Vanessa Yanhua Zhang, Amanda Jing Yang and Sam Sadden for their helpful comments.

2 A judge's pricing of the SEP license fees is actually difficult to be implemented because: (1) the market information on which the judgment is made has often changed when the judgment is made, and the price determined in the judgment may not fit the market situation at the time of the judgment; (2) If the judgment determines a fixed value for the price of the SEP license fees, both the Plaintiff and the Defendant may not want to be bound by the fixed value. However, if the judgment determines a range of variety for the price of the SEP license fees, which is equivalent to the failure of final determination, it is hard for the Plaintiff to apply for enforcement.

tions over SEP license fees, which will not cause disputes. Unfortunately, not all negotiations will reach an agreement, some disputes have to be settled through judicial process, and such disputes have shown an increasing trend in the world over the past two years. The reason for this is that the SEP license has the following special features that restrict the negotiation of SEP license fees:

1. SEP lacks alternative rival patents based on the network effect and lock-in effect of the technical standards. An SEP holder has market advantage over an SEP enforcer and is unwilling to make a compromise;

2. Most patent holders have the obligation to license patents on FRAND (fair, reasonable and non-discriminatory) terms as required by the Standards Setting Organization ("SSO"), but how to define a FRAND license, neither SEP holder nor enforcer has a unified opinion;

3. As the SEP holder is encumbered by a FRAND licensing commitment, which makes it a controversial issue whether the SEP holder can require the enforcer to apply the injunctions in the judicial process as the ordinary patent holder, thus it cannot form clear restraints on the SEP enforcer;

4. Unlike the general mode of "first licensed and then enforced" for ordinary patents, SEP often adopts the mode of "first enforced and then licensed," which means the enforcer will negotiate the license agreement with the patent holder only after the SEP has already been enforced. It may have different impacts toward the enforcer in different cases, such as the negotiation advantage caused by the "first enforce and then licensed" mode, or the negotiation disadvantage due to the fear of losing all prior investments and other sunk costs;

5. Due to lack of information disclosure, SEP holder and enforcer are not symmetrical with each other in terms of information. SEP holder knows very little about the enforcer's production capacity, sales volume and profits, while the SEP enforcer is also not familiar with how the SEP holder issues a patent license to other enforcers, which makes it difficult for both parties to judge the price level of patent license subject to FRAND without the necessary information from both parties.

Among the above-mentioned factors which restrict the negotiation on SEP license fees, the SEP holder's market force and the actual situation that the patent is "first enforced and then licensed" cannot be changed in the judicial process. In addition, it is not easy to determine the judgment standard of FRAND in the judicial process. Only the injunction application and information disclosure can have a more reasonable arrangement in the judicial process, and are the factors that will, more easily to definitely, restraint both the holder and the enforcer. At present, there are more discussions on the injunction application than on information disclosure. Since they are equally important, we will analyze them as follows.

III. GAME THEORY ANALYSIS FOR APPLYING INJUNCTION

Injunctions can be divided into temporary injunctions and permanent injunctions. Temporary injunctions are orders given by the court before or during the litigation to temporarily ban the Defendant from its production, sales and other suspected infringement conduct according to the Plaintiff's application as the court considers that the Defendant's conducts may constitute an infringement and will make it difficult to make up for the Plaintiff's loss if the defendant's conduct are not promptly terminated. Permanent injunctions are orders given by the court after the litigation hearing to permanently ban the Defendant from its production and sales according to the confirmed fact about the Plaintiff's infringement. Both temporary injunctions and permanent injunctions are strongly binding on the patent enforcer. In contrast to permanent injunctions, temporary injunctions are less binding due to the temporality. Additionally, temporary injunctions may not be accepted or may be canceled if the Plaintiff provides security to the court.

There are only three possible arrangements regarding whether the temporary or permanent injunctions may apply to an SEP enforcer. First, under no circumstances can the injunctions apply, and the SEP holder can only claim that the enforcer should pay the license fees or compensate for damages; second, it applies to the same applicable injunction conditions as the ordinary patent (that is to say, on the basis of the application of the SEP holder, a temporary injunction can be issued in case of a preliminary finding of infringement, and a permanent injunction can be pronounced in case of final confirmation of infringement); and third, establishing the applicable injunction conditions different from the ordinary patent, SEP enforcer can apply the temporary and permanent injunctions only when all these special conditions are met. The three different arrangements may give different binding conditions for the negotiation between SEP holder and enforcer, resulting in different game results. As a result, these differences shall be taken into full account in terms of system design.

A. Game Theory Analysis under Different Applicable Injunction Circumstances

1. Game Where the Injunction Can Never Apply

If the SEP holder is deemed to have made a FRAND commitment, it means that once the patent is included in the standard pool, the holder cannot refuse the license and the holder can only negotiate with the enforcer subject to FRAND instead of seeking injunctive relief. In this case, there is little restriction on the negotiation for the enforcer in the short term, and the enforcer can refuse to negotiate to maximize its profit. In a longer period of time, that is, the litigation cycle, although the enforcer will eventually accept the price of the license fees determined by the court, the price of the license fees determined by the court shall comply with the FRAND terms, and theoretically it shall not be higher than the price negotiated between the enforcer and the holder. Therefore, it may not be binding on the enforcer in terms of the negotiation. In other words, the profit gained by the enforcer who refuses to negotiate but accepts the court judgment may not be less than that gained when the enforcer agrees to negotiate. Therefore, the best strategy for the enforcer under the circumstance that the injunction is not applicable, whether in the short or long term, is to refuse to negotiate, while the best strategy of the holder is to agree to negotiate. Therefore, it is difficult to achieve negotiation between the holder and the enforcer. Table 1 gives the strategy arrangement and the likely profit matrix for the holder and the enforcer under the circumstance that the holder can absolutely not seek the injunction, and the maximum profit value of each party is set to be 100.

Table 1. Game Model that the Injunction is Absolutely Not Applicable

		SEP Enforcer	
		Refuse to negotiate	Agree to negotiate
SEP Holder	Refuse to negotiate	0 , 100	0 , 100
	Agree to negotiate	0 , 100	60 , 80

It can be seen in Table 1 that there is no such equilibrium between the holder and the enforcer which is the best strategy for both parties. Therefore, it is difficult to facilitate negotiation between the holder and the enforcer in such a case, even if an agreement is reached, it would be relatively unfavorable to the holder. In addition, the patent holder's enthusiasm to incorporate the patent technology into the standard pool will be undoubtedly undermined. As a result, some excellent technologies will not be included in the standard pool, thereby reducing the overall level of the standard.

2. Game When the Injunctions Are Equally Applicable as the Ordinary Patents

If the SEP and the ordinary patents are applicable to the same injunction application conditions, which would mean that the SEP holder will have more advantages in negotiation than the ordinary patent holder, while the SEP enforcer will be subject to stronger constraints in negotiation. The reasons are as follows.

First, as for the temporary injunction, the holder of the ordinary patent can get the injunction only after he provides the preliminary proof of the Defendant's infringement, but he cannot always make it in the infringement litigation of the ordinary patent, therefore he cannot always get the temporary injunction. However, SEP is usually the patent that the Defendant cannot bypass. As a result, it is easy for the patent holder to prove the Defendant's infringement in the SEP infringement litigation, and thus to easily get the temporary injunction.

Second, for the permanent injunction, if the holder of the ordinary patent insists on asking the Defendant to terminate the infringing conduct, the court will order the Defendant to cease production and sales of the products with the Plaintiff's patent technology as long as the infringement is finally determined. For the ordinary patent, the Defendant may also find the alternative technology with which it may continue the production and sales after being sentenced to stop the infringement. But for the SEP, the enforcer cannot find the alternative technology with which to continue the production and sales after being sentenced to stop the infringement, and the previous equipment, materials, technical training and other sunk costs will come to naught. As a result, whether it is a temporary injunction or a permanent injunction, if it is applicable to the same application conditions as the ordinary patent, the SEP holder will have more advantages in negotiation than the ordinary patent holder, which will exacerbate the imbalance between the SEP holder and the enforcer. In this case, it may be easier for the holder and the enforcer to reach an agreement through negotiation because the enforcer is strongly bound by the negotiation, but the negotiation result may not be a fair one. Table 2 shows the strategies and the likely profit matrix for the holder and the enforcer under the circumstance of the same applicable injunction conditions as the ordinary patent.

Table 2. Game Model when the Injunctions are Equally Applicable as the Ordinary Patent

		SEP Enforcer	
		Refuse to negotiate	Agree to negotiate
SEP Holder	Refuse to negotiate	0 , -100	0 , -100
	Agree to negotiate	0 , -100	100 , 60

It can be seen that there is such a balance in Table 2 that both the SEP holder and the enforcer agree to negotiate and both parties are likely to reach an agreement, but such a negotiation result is likely to be unfair to the SEP enforcer. The adverse consequence is that the enforcer will reduce the implementation of the standard because it is vulnerable to unfair treatment, thus the standard cannot be fully used.

3. Game When Special Conditions are Applicable for SEP Injunctions

There is the third possible arrangement for SEP injunction, that is, to set the application conditions for SEP injunction, different from the ordinary patent. Of course the conditions will not be softer than those of the ordinary patent, as in that case it will further widen the gap between the SEP holder and the enforcer in terms of the negotiation position, making it more unfavorable and unfair to the enforcer. Therefore, we need to consider setting more stringent injunction application conditions than those of the ordinary patent to avoid strong negotiation constraints on the enforcer due to the loose application of the injunctions. Table 3 shows the strategies and the likely income matrix between the holder and the enforcer under the special injunction conditions set for SEP.

Table 3. Game Model when Special Conditions are Applicable for SEP Injunctions

		SEP Enforcer	
		Refuse to negotiate	Agree to negotiate
SEP Holder	Refuse to negotiate	0 , -100	0 , -100
	Agree to negotiate	0 , -100	90 , 70

Same as Table 2, there is a balance between the SEP holder and the enforcer in Table 3 where both parties agree to negotiate, except that a more stringent injunction application condition is particularly set for SEP and it will be unlikely that the holder can easily initiate an injunction. Therefore, the two parties may achieve relatively fair results under the relatively fair negotiation constraints.

To sum up the simple game theory analysis under the three different arrangements mentioned above: the absolute non-application of the injunctions will lead to an imbalance in the game between the SEP holder and the enforcer, which will be least favorable to negotiations and protection of the interests of the SEP holder, and thus undermine the patent holder's enthusiasm to incorporate the patent technology into the standard. The same injunction application conditions applicable to the ordinary patent will form stronger negotiation constraints on the SEP enforcer than those on the ordinary patent enforcer, and there are balanced strategies that can easily facilitate the negotiations, but can also easily lead to negotiation results unfavorable to the SEP enforcer, and thus affect the full implementation of the standard. In addition, the special injunction application conditions set for SEP also have balanced strategies that are likely to facilitate the negotiations and relatively easy to achieve the negotiation results which are comparatively fair to both the holder and enforcer. The results are conducive to promoting the standard to absorb excellent technologies, but also conducive to the implementation and application of the standard.

B. Suggestions on Setting SEP Injunction Application Conditions

From the legal practice of each country, the cautious attitude towards the application of SEP injunctions has become a more consistent trend, and some jurisdictions have even tried to set special conditions for the application of SEP injunctions. In the United States, the Supreme Court stated in the 2006 decision *eBay Inc. v. MercExchange* that it was not necessary to issue an injunction to prevent future infringement once the patent was infringed.[3] In January 2013, the U.S. Department of Justice and the Patent and Trademark Office jointly issued the *Policy Statement on Remedies for Standards-Essential Patents Subjects to Voluntary F/RAND Commitments* to reflect a cautious attitude towards the issuance of the injunctions.[4] In August 2013, on the ground of "public interest" reasons, the Executive Office of the President overturned the U.S. International Trade Commission's authorization given to South Korea's Samsung to implement an "exclusion order" towards Apple on some electronic equipment.[5] In Europe, the European Commission established the "Safe Harbor Principle" in the antitrust investigation against Motorola and Samsung in April 2014,[6] while the European Court of Justice made three injunction application conditions for the SEP enforcer in the patent infringement case of "*Huawei v. ZTE*."[7]

3 *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006).

4 *Policy Statement of Remedies for Standards-Essential Patents Subject to Voluntary F/RAND Commitments*, United States Department of Justice and United States Patent & Trademark Office, January 8, 2013, available at: https://www.justice.gov/sites/default/files/atr/legacy/2014/09/18/290994.pdf.

5 Letter "RE: Disapproval of the U.S. International Trade Commission's Determination in the Matter of Certain electronic Devices, Including Wireless Communication Devices, Portable Music and Data Processing Devices, and Table Computers, Investigation No. 337-TA-794", Executive Office of the President of the United States Trade Representative, August 3, 2013, available at: https://ustr.gov/sites/default/files/08032013%20Letter_1.PDF.

6 Commission Decision of 29.04.2014, Case AT.39985 - Motorola - Enforcement of GPRS Standard Essential Patents, available at: http://ec.europa.eu/competition/antitrust/cases/dec_docs/39985/39985_928_16.pdf.

7 *Huawei Technologies Co. Ltd. v. ZTE Corp., ZTE Deutschland GmbH*, Judgment of the Court, July 16, 2015, available at: http://curia.europa.eu/juris/document/document.jsf?docid=165911&doclang=EN.

The three conditions are: (1) Before the litigation, the Plaintiff shall first notify the Defendant in writing of the specific patent it infringed and the way of infringement; (2) If the Defendant expresses its willingness to come to an agreement with the Plaintiff on FRAND license terms, the Plaintiff shall provide the Defendant with a clear, written and easily accepted FRAND offer, including the calculation, method and specific rate of the patent license fees; (3) If the Defendant violates the principle of honesty and credibility and the commonly accepted business practice and fails to make a reasonable counter-offer or promise to the Plaintiff within a reasonable period, or if the local court or the arbitration body gives a ruling on the basis of the RAND principle, and the Defendant makes it clear that it is unwilling or unable to perform. In China, the Supreme People's Court published the *Interpretation of Several Issues Concerning the Application of Law in the Trial of Infringement of Patent Disputes (II)*[8] in March 2016, Article 24 of which provides that it shall not be sentenced to stop the act of infringement if the SEP holder fails to disclose to the Standard-Setting Organization its patent information, the SEP holder intentionally violates its obligations of the FRAND commitments, or the SEP enforcer make no obvious fault in the negotiations, the court cannot order the termination of the infringement, that is, the injunctions shall not be applied.

It seems that there are some differences between the United States, Europe and China in these legal practices. The United States did not explicitly set special injunction application conditions for SEP, but only invoked the basic principles about injunction application in the rule of equity and emphasized that the injunctions shall not be implemented in some cases, for instance, if the enforcer pays enough money compensation to cover the holder's loss, or if the injunctions will harm the public interest. On the contrary, both Europe and China tried to set special injunction application conditions for SEP, and these conditions are basically the same with the core being that the SEP holder has faithfully fulfilled the obligations of the FRAND commitment, but the FRAND negotiation failed to proceed or come to an agreement due to the reasons of the enforcer. It should be mentioned that the practice of the United States can be used for reference for Europe and China, especially in terms of the injunction application for a Non-Practicing Entity (NPE). The fact is that NPEs themselves take no advantage of patent production and sales and will not compete with the patent enforcer. In addition, the NPE itself will not lose the market shares due to patent infringement and the money compensation is enough to make up for the NPE's loss, therefore it is allowed to exclude the application of the injunctions. However, the United States still applies the same injunction application conditions to SEPs as to ordinary patents. In contrast, Europe and China have tried to set special injunction application conditions for SEP, which deserve more attention both in facilitating negotiations and in promoting fairness. Europe and China, in fact, take the fulfillment of the FRAND license obligations as the basis for the SEP holder to advocate the patent rights including the injunctive relief. Regardless of the nature of the obligations of the FRAND commitment in law, it is indeed the key to make SEP different from the ordinary patent in terms of the applicable injunction conditions. In general, the SEP injunction application conditions identified by the European Court of Justice in *Huawei v. ZTE* and the regulations on SEP injunction application in the judicial interpretation of the Supreme People's Court of China are more appropriate, but some conditions still remain vague, which are not conductive to forming clear negotiation constraints. In addition, it is not obvious to give consideration to the constraints on the holder and the enforcer.

For the current legal practices, one possible improvement is to strengthen and clarify some conditions in two aspects where the SEP holder seeks an injunction and the SEP enforcer opposes the injunction, and these conditions bind the parties to facilitate negotiations. As the preliminary suggestions mentioned in Table 4, these suggestions are more stringent than those in *Huawei v. ZTE* which seek injunctions for the SEP holder, but at the same time, these suggestions also set more stringent conditions for the SEP enforcer to oppose the injunctions, and also set more stringent conditions for the court to make injunction decisions accordingly. Moreover, these conditions also try to avoid some subjective conditions such as fault judgment.

8 *Interpretation of the Supreme People's Court of Several Issues Concerning the Application of Law in the Trial of Infringement of Patent Disputes (II)*, Law Interpretation No.1 (2016), the Supreme People's Court, March 21, 2016, available at: http://www.sipo.gov.cn/zcfg/flfg/zl/sfjs/201603/t20160322_1253917.html.

Table 4. The Conditions for the SEP Holder to Seek the Injunctions and the SEP Enforcer to Oppose the Injunctions

Conditions for the SEP holder to seek the injunction	1. Disclose its patent information in SSO. 2. Before the litigation, the SEP holder shall notify the enforcer of the infringement conduct, the patent infringed and the way of infringement in writing. 3. Make a clear FRAND license offer before the litigation, including the specific price conditions and calculation basis. 4. Within a reasonable time period (such as two to three months) waited before the litigation, the enforcer fails to reply to the FRAND license offer or make a reasonable counteroffer.
Conditions for the SEP enforcer to oppose the injunctions	1. Acknowledge the FRAND license offer given by the SEP holder or make a reasonable counteroffer within a reasonable time period. 2. Refer to the highest market license fees of the same patent in the same corresponding period (under the same patent constraint) with regard to the requests for temporary injunctions, and deposit the license fees to the court's escrow account according to the sales volume.
Conditions for the court ruling to implement the injunctions	1. The conduct of infringement accused by the SEP holder is established. 2. For the temporary injunctions, be sure to satisfy the conditions for the SEP holder to seek the injunctions as mentioned in this table, other than the conditions for the SEP enforcer to oppose the injunctions. 3. For the permanent injunctions, be sure to have at least a substantial round of negotiations with the host of the court before the injunction decisions are made.

IV. GAME THEORY ANALYSIS FOR INFORMATION DISCLOSURE

To set the special conditions for SEP injunction application only makes clear and strengthens the constraints on the negotiation between the SEP holder and the enforcer, but the biggest obstacle to be overcome in the negotiation is information asymmetry, which needs to be resolved through information disclosure.

A. Different Game Results with or without the Obligation of Information Disclosure

When negotiating based on FRAND conditions and determining whether the license fees are subject to the FRAND level, the SEP holder and the enforcer will definitely be required to disclose some trade secrets. Therefore, it is a very controversial issue whether to set the parties a mandatory obligation of information disclosure in the litigation of SEP license fees. Setting a mandatory obligation of information disclosure for the SEP holder will render the SEP holder reluctant to proceed with litigation and negotiations, thereby reducing the patent technology incorporated into the technical standards due to the lack of effective protection of patents. However, it will form totally different negotiation constraints on the SEP holder and the enforcer with or without the obligation of information disclosure, thereby giving rise to the completely different negotiation results.

1. Game under the Circumstance without the Obligation of Information Disclosure

Both parties are not obliged to disclose the information under the circumstance without the obligation of information disclosure, and one party will decide whether to disclose according to the other party's decision. In this dynamic game, if one party discloses the information, the other party may disclose or may not disclose the information; but if one party does not disclose the information, the other party will certainly not disclose the information. Figure 1 and Figure 2 separately give the game tree under the two-stage game circumstance (that is, there is no repeated game situation) where the other party makes the follow-up decision after the SEP holder or the enforcer makes the decision.

Figure 1. Circumstance where the SEP Holder Makes the Decision First

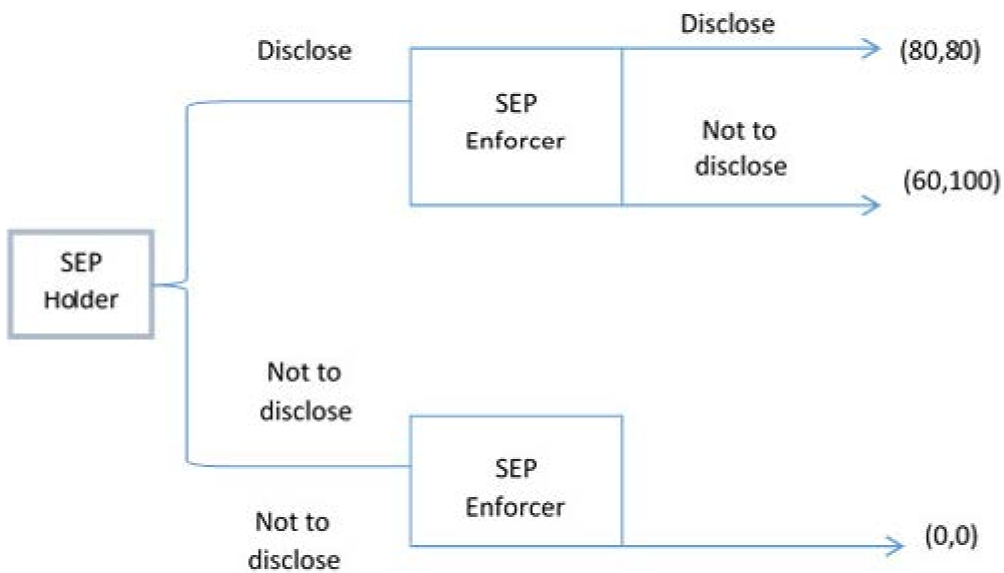
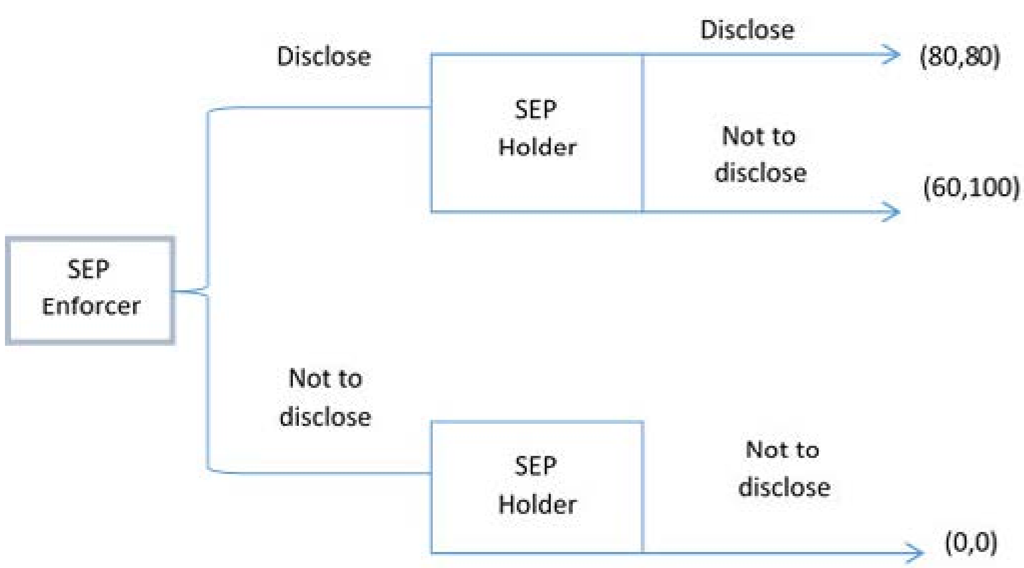


Figure 2. Circumstance where the SEP Enforcer Makes the Decision First



In the absence of the obligation of information disclosure, if the one who makes the decision first chooses to disclose, the one who makes the decision later may choose the strategy of (disclose, disclose) by considering reputation and long-term cooperation, which may produce a result mutually beneficial to both parties. But if it is a one-time deal (that is, there is no repeated game), the one who makes the decision later may choose not to disclose due to the optimal benefit strategy (disclose, not to disclose), which will maximize its own benefit but minimize the other party's benefit. If the one who makes the decision first chooses not to disclose, the one who makes the decision later will also choose not to disclose, and the negotiation will then come to a deadlock.

2. Game under the Circumstance with the Obligation of Information Disclosure

And then let's take a look at the game under the circumstance with the obligation of information disclosure. If the judge is allowed to force both parties to disclose relevant information under certain conditions, and the parties will bear the penalties and other economic consequences if they fail to disclose the information, it can be seen that the negotiation game between the SEP holder and the enforcer will be a static game about complete information. In addition, Table 5 shows the strategies and the profit matrix for the game between the parties under the circumstance with the obligation of information disclosure.

Table 5. Game Model with the Obligation of Information Disclosure

		SEP Enforcer	
		Disclose	Not to disclose
SEP Holder	Disclose	80 , 80	100 , -100
	Not to disclose	-100 , 100	100 , -100

It can be seen that there is a unique Nash equilibrium (disclose, disclose) in Table 5, which will be very beneficial for both parties to reach an agreement, indicating that institutional arrangement with the obligation of information disclosure is the most favorable institutional arrangement for facilitating both parties to conclude an agreement.

B. Suggestions on how to Set the Obligation of Disclosure

Based on the aforementioned game analysis, there is no doubt that the circumstance with the obligation of information disclosure is far more conductive to negotiate between both parties than the circumstance without the obligation of information disclosure. We need to deal with the following questions: First, should we set the mandatory conditions for information disclosure? Second, how to balance the inconsistency between information disclosure and protection of trade secrets in case of mandatory information disclosure.

With regard to the first question, since there is still the possibility of the strategy of (disclose, disclose) under the circumstance without mandatory information disclosure, as mentioned above, it is not necessary to initiate mandatory information disclosure in SEP litigation, but rather to voluntarily disclose the information by both parties. Only when one party or both parties are reluctant to disclose the information or if the information disclosed is not sufficient, the judge may make a decision to force one party or both parties to disclose the relevant information on the basis of one party's application or by self-decision. The parties involved may also raise an objection to the judge's decision of mandatory information disclosure. For example, the information disclosure is not necessary for settling the disputes, or the information to be disclosed at the request of the judge goes beyond the need to resolve the dispute and other circumstances. The judge shall make a written resolution to the parties' written objection. In fact, it is also foreseeable that as long as the judge is given the right to compel both parties to disclose relevant information under certain conditions as described in Table 5, it may constitute a constraint. In addition, the parties may be inclined to voluntarily disclose the information in the litigation before the judge forces both parties to disclose information, which can prevent the judge's decision from expanding the scope of information disclosure.

With regard to the second question, that is, how to protect the trade secret while being forced to disclose business information? In fact, the court has accumulated a wealth of experience in handling contract disputes, corporate disputes, intellectual property disputes, labor disputes and so on and even criminal cases, which can be completely used as reference for FRAND negotiations in SEP litigation. For example, the importance level of the information to the parties can be used to determine the scope of the object of disclosure: (1) top trade secrets can only be disclosed to the judge and the experts authorized by the judge; (2) sub-important trade secrets can only be disclosed to both parties' lawyers, other than the parties; (3) ordinary trade secrets can be disclosed between the parties and the parties' lawyers, but under the condition of secrecy measures such as signing of confidentiality commitment, prohibition of photocopy, prohibition of excerpt, limited reading spot, and so on. To sum up, the judge shall be given the right to compel both parties to disclose relevant information in SEP litigation to facilitate the negotiation between the SEP holder and the enforcer. It does not mean to initiate the mandatory disclosure of information in the litigation, but the judge shall have the right to force one party or both parties to disclose relevant information if the negotiation cannot be achieved due to no disclosure of relevant information by the parties. Imagine that even if the SEP holder and the enforcer still cannot reach an agreement after disclosing the relevant information, the judge will be more likely to make a more accurate judgment of the license fees with the information.

V. CONCLUSION

The injunction application and information disclosure are two important factors in restricting the negotiation over SEP license fees in litigation. Based on the results of game theory analysis, it will be most favorable to facilitate the negotiation to set the special injunction application conditions for SEP among the three arrangements when the injunction can never apply, the injunctions are equally applicable as the ordinary patents, and special conditions are applicable for SEP injunctions. When setting the injunction application conditions, we can set some more stringent conditions than those of the ordinary patents from the two aspects that the SEP holder seeks the injunctions and the SEP enforcer opposes the injunctions. At the same time, these conditions shall be objective and clear to strengthen the constraints on the negotiation between the parties. Similarly from the results of game theory analysis, Nash equilibrium can be achieved in disclosure of information by the parties under the circumstance of setting the obligation of information disclosure for the parties with regard to whether or not to implement the mandatory information disclosure toward the SEP holder and the enforcer, which is far more favorable to facilitating the negotiation between the parties than not setting the obligation of information disclosure. As a result, it is recommended to give the judge the right to compel the parties to disclose the relevant information under certain conditions. Of course, it should be emphasized that it is not necessary to make the parties disclose the information to settle the disputes. The content of the information disclosed is strictly limited by the scope required for the settlement of the disputes, and different secrecy measures shall be taken according to the importance of the information in the process of information disclosure.

FIRST YEAR OF ENFORCEMENT OF THE COMPETITION ORDINANCE IN HONG KONG

BY PING LIN & THOMAS W. ROSS[1]

I. INTRODUCTION

Hong Kong's Competition Ordinance ("CO") came into effect on December 14, 2015, three and a half years after its enactment. This article reviews what proved to be an active first year for the new competition policy regime. We begin by summarizing the considerable amount of work undertaken by the Hong Kong Competition Commission ("HKCC") in advance of the full implementation of the law. We then describe the high level of activity through the law's first year: including advocacy work, market studies, investigations of complaints (to the point of escalating some cases to the investigation stage). While there is still yet a single case to be formally charged, HKCC's enforcement effort has had a real impact on some important sectors of the economy, and has raised awareness of the CO by educating the public about the new law. We review the major enforcement activities by the HKCC and provide an assessment of its "complaints-driven" approach, from the decision theory viewport and in light of the fact that Hong Kong does not have a merger control regime.

II. THE COMPETITION ORDINANCE AND ESTABLISHMENT OF THE HKCC

After an extended period of consultation and debate, the CO was adopted in June 2012. Getting to this point was not easy for competition law supporters: there was considerable unease in some quarters in Hong Kong – particularly in the small and medium-sized enterprise ("SME") sector – about regulatory overreach. Several compromises were necessary to move forward, but the result was a modern competition law, at least with respect to horizontal agreements and abuse of dominance.[2] The key prohibitions of the CO take the form of two "Conduct Rules" modelled on European antitrust law: (1) the First Con-

1 Lin: Lingnan University, Hong Kong; Ross: University of British Columbia, Vancouver, Canada.

2 On the compromises, see, e.g. P. Lin and J. Zhao, "Recent Amendments to Hong Kong's Competition Bill," Competition Policy International, 2012.

duct Rule ("FCR") prohibits agreements and concerted practices that restrict competition; and (2) the Second Conduct Rule ("SCR") prohibits an undertaking with a substantial market power from abusing that power by engaging in conduct that restricts competition. The CO also contains a "Merger Rule" that – at this time – only applies to the telecoms sector.

The CO further provided for the establishment of the HKCC. The first panel of commissioners of the HKCC was appointed in April 2013 by the Hong Kong SAR Government, and the first CEO was named in July 2014. Cases investigated by the HKCC can be brought to the newly created Competition Tribunal which determines whether the alleged conduct constitutes contraventions of the CO and, if so determined, the level of penalty or appropriate remedies.

III. PREPARING FOR THE COMMENCEMENT OF THE CO

Between the passage into law of the CO and its coming into force in December of 2015, a great deal of work was undertaken to prepare the Hong Kong business community, and the HKCC itself, for this new competition policy regime.

From the appointment of the first commissioners in 2013, the HKCC was built up quickly with a combination of local and international hiring, leading to a staff of 47 members by March 2016.[3] At the time the CO took effect, the HKCC was "ready to take on the challenges ahead," claimed then-CEO Stanley Wong.[4]

In terms of capacity building, in addition to getting help from the major competition agencies from the EU, the United States, and the International Competition Network (of which the HKCC is a member), the HKCC also sent staff members on secondment in Australia, New Zealand, Singapore and Canada during 2014-2015. Such arrangements provided "invaluable experience on cartel investigation matters, including dealing with leniency applications."[5] It is interesting to note that these countries all belong to the category of small modern economies, which may indicate the HKCC's intention of learning from the kind of experiences most relevant to Hong Kong. Notably, in December 2016, the HKCC signed its first memorandum of understanding with a foreign competition authority – the Canadian Competition Bureau. Such MOUs facilitate cooperation between authorities on areas of mutual interest, such as enforcement activity involving multinational companies.

A. Guidelines and Advocacy

To encourage compliance and reduce the need for expensive, formal legal actions, modern competition authorities will devote considerable resources educating market participants about their rights and obligations under competition law. This is a particularly important activity for new authorities, and the HKCC clearly saw this need.

As required by the CO, the HKCC developed a series of guidelines to inform Hong Kong's business community about how the various sections of the CO are to be interpreted and how the HKCC expects to enforce them. In July 2015, a set of six guidelines were published after an extended period of drafting, public consultation and revision: the Guideline on the First Conduct Rule, the Guideline on the Second Conduct Rule, the Guideline on the Merger Rule, and three other guidelines on handling complaints, conducting investigations and on exclusions and exemptions, respectively.

3 HKCC Annual Report 2015/16.

4 HKCC Press Release, "Competition Ordinance Comes into Full Effect Today", December 14, 2015; available at: https://www.compcomm.hk/en/media/press/files/Competition_Ordinance_Comes_into_Full_Effect_Today_EN.pdf. Unfortunately, the HKCC did lose the experienced leadership of Mr. Wong when serious ill health forced his resignation in March 2016. He passed away in April 2016.

5 Anna Wu, "Fighting Cartels Under the Hong Kong Competition Ordinance: Lessons from the European Union," keynote speech at Competition Law Conference of the Chinese University of Hong Kong, March, 2015.

Among other advocacy and educational activities prior to the CO taking effect, the HKCC in fact directed attention to, and had impact on, some key sectors in Hong Kong. Specific brochures were prepared and published, including some targeting the SME sector as well as trade associations in Hong Kong.

For example, the HKCC started a program focusing on trade associations in mid-2014 aimed at promoting compliance with the new law. On 16 June 2015, the HKCC launched (via a press conference and media release) a brochure titled "The Competition Ordinance and Trade Associations." The brochure, sent to over 500 trade associations and professional bodies in Hong Kong, provides clear, practical guidance on what associations should and should not do to ensure the associations and their members comply with the CO, using an easy-to-understand approach with hypothetical examples and illustrations. In addition, HKCC also engaged directly with the trade associations by reviewing their trade practices that might constitute contraventions of the CO, one important area being publishing fee scale/fee schedules for members. The program turned out to be very effective. Based on its review of publicly available information (on trade associations' websites), the HKCC identified over 20 trade associations that appeared to fall within a high risk category. After direction communications and engagements with the HKCC, 12 of these trade associations had indicated publicly, in November 2015, that they had revised their conduct or were in the process of doing so before or shortly after the full commencement of the CO to remove one or more price restrictions/fee scales.[6]

B. Enforcement Policy and Priorities

The HKCC published its Enforcement Policy document in November 2015, shortly before the CO came into effect.[7] The Enforcement Policy supplements the CO and the six Guidelines to provide guidance on how the HKCC intends to exercise its enforcement function in investigating possible contraventions of the First Conduct Rule and the Second Conduct Rule of the CO.

The Enforcement Policy sets out six "core principles" to which HKCC will adhere in conducting investigations: specifically they will be professional, confidential, engaged, timely, proportionate and transparent. In spelling out the HKCC's approach to setting enforcement priorities, the document explains that during the initial years of the operation of the CO, the Commission's resources should be focused on "encouraging compliance with the Ordinance in the Hong Kong economy as a whole, rather than focusing on specific sectors. The Commission will achieve this through a mix of education, engagement and enforcement." It goes on to indicate that the Commission will: (a) target anti-competitive conduct that is clearly harmful to competition and consumers in Hong Kong; and (b) commence proceedings in the Tribunal in appropriate cases to, over time, obtain judicial interpretation of the CO.

When considering whether to investigate a particular case, the HKCC will accord priority to those cases which involve any one or more of the following types of conduct: (a) cartel conduct (agreements of concerted practices involving price-fixing, market sharing, output restriction, or bid rigging); (b) other agreements contravening the First Conduct Rule causing significant harm to competition in Hong Kong; and (c) abuses of substantial market power involving exclusionary behavior by incumbents.

C. Leniency Policy

Also in November 2015, the HKCC published its Leniency Policy for Undertakings Engaged in Cartel Conduct. The policy provides an overview of the HKCCs approach to leniency applications as well as a template leniency agreement which will form the basis of all leniency agreements to be entered into between the HKCC and successful leniency applicants. Using a "marker system," the HKCC agrees to not to commence proceedings for a pecuniary penalty against the first cartel member who reports cartel conduct to the Commission and meets all the requirements for receiving leniency. One such requirement is that the member had not coerced other members to participate in the cartel. Leniency is also extended to relevant current and/or past employees.

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6 See HKCC, "Report on Trade Associations in Hong Kong and the Competition Ordinance," 2015, which lists the names of those 12 trade associations (but not the others); available at: https://www.compcomm.hk/en/media/reports_publications/files/TA_project_report_EN.pdf.

7 See HKCC, "Enforcement Policy," 2015; available at: https://www.compcomm.hk/en/legislation_guidance/policy_doc/files/Enforcement_Policy_Eng.pdf.

IV. FIRST YEAR OF ENFORCEMENT

Launched with the benefit of all this preparatory work, the first year under the CO was an active one for the HKCC. It included further advocacy work, market studies, one block exemption, investigating a large number of complaints (some of which may advance toward interventions) and even the drafting of another guideline document.

A. Chairperson's Letter to Hong Kong: Day Zero

On December 14, 2015, the day before the CO came into effect, Ms. Anna Wu, Chairperson of the HKCC issued a Letter to Hong Kong, via a local radio channel, in which she reminded businesses in Hong Kong to embrace the commencement of the CO. In the letter, Ms. Wu stated that "many honest businessmen as well as unsuspecting consumers have fallen victim to anti-competitive conduct such as cartels and the exclusionary behaviour of businesses with substantial market power." She cited studies from the OECD that the illegal gains from price fixing amounted to around 10 percent of selling prices and that contract prices of public procurements fell by about 20 percent in Japan after strict enforcement against bid-rigging.[8] (She also pointed out that bid rigging "has become a topical subject in Hong Kong," and "is rife in the local building maintenance industry.") In addition to educating the public about harms of anti-competitive behavior, citing those specific price declines may also be seen as an indication of the HKCC's belief of what enforcement of the CO would do for Hong Kong consumers, at least in the area of cartels.

B. Block Exemptions

In September 2016, the HKCC issued its first proposed block exemption order for certain shipping liner agreements. Through the publication of the proposed decision and the associated preliminary views, members of the public and potential applicants for block exemptions would have a better understanding of the Commission's criteria for applying the efficiency exemption, thus providing more certainty to businesses and market players. The HKCC invited interested persons to make representations on the proposed block exemption up to December 14, 2016 and is now considering those representations.

C. Across-the-Board and Complaints-Oriented Approach

Regarding the often-asked question of which sectors it would take enforcement actions against first, the HKCC made it clear before the commencement of the CO and publications. In particular, the HKCC does not take a sectoral approach but instead will monitor all sectors of the economy. Consistent to this, the HKCC made it clear that it is complaints-driven and focuses more of its attention to sectors and types of conduct it has information about, as received via various channels.[9] One source of such channels is complaints and public reports of suspected anti-competitive practices in certain sectors.

Prior to full commencement of the CO, the HKCC had received a number of complaints, queries and referrals (from other government agencies) about potential competition issues ("enforcement contacts"). It received a surge in enforcement contacts on and after December 14, 2015. Between December 14, 2015 and March 31, 2016, the HKCC received a total of 924 enforcement contacts. The majority of these contacts were related to possible violations of the First Conduct Rule, with cartel conduct and resale price maintenance being the major concerns.[10] By the end of 2016, the HKCC had received nearly 1,900 complaints and queries. Of this

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8 See: http://programme.rthk.hk/channel/radio/programme.php?name=radio3/lettertohongkong&d=2015-12-13&p=535&e=336626&m=episode.

9 Ms. Anna Wu made this approach public in a speech in October 2015, two months before the commencement of the CO. See: https://www.compcomm.hk/en/media/press/files/20151030_GCR_Live_Conference_speech.pdf.

10 Each case may involve allegations of multiple types of anti-competitive conduct. The contacts include complaints, queries and referrals from other agencies, but exclude intelligence gathered independently by the HKCC. See Annual Report 2015-2016, Figure 1, p.49, available at: https://www.compcomm.hk/en/media/reports_publications/files/2015_16_CC_Annual_Report.pdf.

total, over 50 percent related to the First Conduct Rule issues, with cartel conduct being the major concern, especially bid-rigging. About 20 percent of the complaints and queries raised concerns related to the Second Conduct Rule.[11] Approximately 130 cases had been escalated for further assessment. The escalated cases spanned over 21 sectors, with *Property & Property Management* and *Professional & Technical Services* being the top two sectors involved.[12] Over 10 percent of these cases have proceeded to in-depth investigations.

As set out in its Guideline on Complaints, Guideline on Investigations and in its Enforcement Policy, the HKCC considers all complaints and queries it receives and escalates those that warrant further assessment to an Initial Assessment phase.[13] Up to March 31, 2016, the HKCC escalated 97 cases to the Initial Assessment phase. These Initial Assessment cases were either initiated by HKCC of its own volition based on intelligence; initiated in response to contact from whistle-blowers or leniency applicants or escalated in response to enforcement contacts the HKCC had received. For example, while approximately 21 percent of the enforcement contacts received up to March 31, 2016, are related to cartel conduct, 62 percent of the Initial Assessment cases fall into cartel category. On the other hand, while approximately 22 percent of enforcement contacts related to allegations of RPM, only 18 percent of Initial Assessments related to alleged RPM. These figures about the escalation process are said by the HKCC to reflect its "strategic enforcement focus, as set out in its Enforcement Policy,"[14] namely that RPM is not of as high priority as cartel conduct.

Regarding its compliance project on trade and professional association which started in mid-2015, as mentioned above, the HKCC continued to have made progress during the past year. As of December 14, 2016, nineteen out of over twenty high-risk trade associations identified by the HKCC have removed price restrictions and/or fee scales during the year as a result of the Commission's engagement efforts.[15] Indeed, as the HKCC claims, this project has cast a widespread positive impact in the community.[16]

During the past year, HKCC made substantial use of its compulsory evidence gathering powers in conducting its investigations by, for example, using "dawn raids" and seizing files as well as physical devices containing relevant data. It also looked at communications via personal mobile phones (e.g. Whatsapp, WeChat) and found "some of the most valuable evidence" for certain cases.[17]

The Commission has also made encouraging progress with its compliance project on trade and professional associations. Nineteen out of over twenty high-risk trade associations identified by the Commission have removed price restrictions and/or fee scales during the year as a result of the Commission's engagement efforts. These associations are key to changing behavior by their members and their compliance with the Ordinance has cast a widespread positive impact in the community. The engagement with trade associations revealed telling information about how some businesses had viewed their business practices. For example, the Hong Kong Institute of Surveyors was one of the associations that had published a "recommended" scale of professional charges for its members for more than ten years, with the justification that the public would not know what a reasonable charge level is. The

11 HKCC Press Release, December 14, 2016.

12 Other sectors include transport & logistics, food & groceries, construction & infrastructure, financial products & services, apparel, footwear, jewelry, watches & accessories, and others. See Figure 3, HKCC Annual Report, 2015-2016, p.51, for the sectors covered during December 14, 2015 to March 31, 2016.

13 As outlined in HKCC's Guideline on Investigation, the Initial Assessment Phase is used by the Commission to identify, as appropriate, it is reasonable to conduct an investigation and there is sufficient evidence to establish a reasonable cause to suspect that a contravention of a Competition Rule has occurred, using information received or sought on a voluntary basis. In the Investigation Phase, HKCC may use of the compulsory document and information gathering powers provided by the CO to conduct investigation.

14 HKCC Annual Report, 2015/2016, p. 51.

15 HKCC Press Release, 14 December, 2016.

16 Ms. Anna Wu, Chairperson of the HKCC, stated that "with the Commission's advocacy effort since its establishment, many businesses are making genuine efforts to understand and comply with the new law. In time, I am confident that the full benefits of the Ordinance and its potential to enhance Hong Kong's overall economy will be felt in all aspects of our daily lives."

17 Rose Webb, CEO of HKCC, speech at Panel Discussion at Freshfields, Hong Kong, December 9, 2016.

recommended price scale was removed by the Institute as a result of the engagement project of HKCC. In another high-profile example, in May 2016, as a result of advice delivered in meetings with staff of the HKCC, the Hong Kong newspaper Hawker Association withdrew a letter it had sent to its members recommending retail prices on certain branded cigarettes.

D. Advocacy

The HKCC regards advocacy "as important as enforcement action," especially at the introductory stage of a new law. Over the past year, the HKCC has continued to put a great deal of effort and a number of innovative ideas toward raising public awareness and fostering a compliance culture in Hong Kong. For example, the HKCC directed several activities toward educating the public about how to detect and prevent bid-rigging cartels. In May 2016, the Commission launched a multi-pronged "Fighting Bid-rigging Cartels" Campaign as its first major public advocacy initiative, using roving exhibitions, educational videos and broadcast media programming, etc.[18] The Campaign was supported by extensive online and outdoor advertising and seminars to enhance public awareness. In August, publicity posters of the Campaign were sent to the owners' corporation of over 15,000 residential and commercial properties in Hong Kong. The HKCC won eight local and international awards during the year for its outreach and publicity activities with its innovative and accessible approach to competition law advocacy gaining recognition around the world.[19]

The HKCC has noted some other effects on competitive behavior even without direct enforcement action. For example smart phones retail prices reportedly fell as much as 20 percent for some brands shortly after the CO took effect. This can be interpreted as the retailers ignoring the RPM policy set by the manufacturers or alternatively that the manufacturers suspended or stopped their long-time RPM policy. There is no public information now regarding how long the price drop lasted.[20]

E. Market Studies

Market studies have been used by competition agencies around the world to gain understanding of competition situations in selected markets/sectors. The CO provides the HKCC with the authority "to conduct market studies into matters affecting competition in markets in Hong Kong" and "to advise the Government on competition matters in Hong Kong and outside Hong Kong."[21]

A major market study HKCC undertook during the past year was that of the residential building renovation and maintenance sector. Partly in response to media reports and other sources suggesting that bid-rigging was common in Hong Kong's residential building renovation and maintenance sector, the HKCC undertook a study into certain aspects of the market in May 2016. The overall result of the study is consistent with the widespread concern that bid-manipulation practices were prevalent in the local residential building renovation and maintenance market in the recent past.[22]

Two types of bid-manipulation practices were examined in this study. One type occurs when competing contractors engage in bid-rigging cartel conduct or other collusive behavior intended to influence – in their favor – the outcome of the tender for their services. A second type occurs where a consultant and a contractor conspire with each other so that the particular consultant wins the bid to oversee the tender for the physical works (sometimes by putting in an extremely low bid for the consulting services), and

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18 The HKCC even had soap opera stars record one-minute videos that aired on local television stations after the evening news. J. VanDerMiller "Reflecting on Year 1 of Hong Kong Competition Enforcement," *LAW 360*, https://www.law360.com/articles/861598/reflecting-on-year-1-of-hong-kong-competition-enforcement.

19 HKCC Press Release, December 14, 2016.

20 South China Morning Post, January 3, 2016.

21 Competition Ordinance, Section 130.

22 See Hong Kong Competition Commission, *Report on study into aspects of the market for residential building renovation and maintenance*, May, 2016; https://www.compcomm.hk/en/media/reports_publications/files/Report_on_market_study.pdf.

then organizes for its allied contractor to win the bid for the renovation work at an inflated price.

The HKCC used some of the screening techniques developed by economists and used in such cases as the LIBOR scandal in the UK and highway public tenders in the United States. These techniques were applied to actual bid and participation data from Hong Kong's residential building renovation and maintenance services market prior to when the CO came into effect. The one-year study revealed patterns that would be consistent with the wide-spread feeling among the public that there may have been problems in the sector. Although any bid-rigging, if it did occur during the time period the study covered, would not be a violation of the CO, (as it would have been prior to the CO taking effect), the HKCC did state, very clearly in its report, that "it would very likely investigate further certain patterns highlighted by the analysis," if similar results were obtained today. The HKCC was clear and stern in its warning that:

> Those who might be tempted to manipulate bids in contravention of the competition rules should know that the Commission is watching and it has at its disposal a number of tools to detect such contraventions. The Commission understands what has been taking place, and it will investigate where it can. Those contemplating rigging a bid should abandon such projects. Those already involved in rigging bids should realise that they are involved in serious anti-competitive conduct and should do the right thing by approaching the Commission to apply for leniency under the Commission's Leniency Programme to avoid the risk of facing substantial penalties and other sanctions. Commission has identified bid-rigging cartels as a priority for enforcement and will use the full extent of its powers to end bid-rigging cartels. (p. 12 of the Report)

The HKCC also used the above study as an opportunity to set up its general purpose and approach in conducting market studies. In the above report, it is stated that "The main objective of a market study is to examine if competition within a market is working well or can be improved; it does not seek to establish general rules and obligations for firms." The Commission can look at firm conduct as it relates to the functioning of competition in the market generally, and it can also look for structural aspects of the market (including barriers to entry and expansion) or the conduct of customers that might cause insufficient competition in the market.

> If the Commission identifies that there are systematic problems of insufficient competition in a market, it can take a number of steps. For instance, if the Commission identifies that there is problematic conduct potentially falling foul of the Competition Ordinance by a number of firms in the market, it may identify that sector as meriting priority in enforcement case selection. Additionally, if the Commission identifies that there is a structural competition deficit within the market that may be solved through Government policies or action, it may make appropriate recommendations to the Government in accordance with its government advisory function. The Commission may also consider whether education of market participants would assist in resolving the problems identified. (p. 2 of the Report)

The HKCC also studied the supply of piped liquefied petroleum gas to rental housing estates in Hong Kong and provided competition-related advice to the Hong Kong Housing Authority on the awarding of supply contacts in September 2016, so as to improve upon the existing practice of contract renewal that favors the incumbent suppliers.[23]

F. Guide to Proceedings in the Competition Tribunal: Follow-on Action

The Competition Tribunal has provided some additional guidance of its own. In December 2015, it issued a document titled *The Guide to Proceedings in the Competition Tribunal: Follow-on Action*. The Guide aims to provide the public with a brief outline of the practice and procedure of follow-on proceedings in the Competition Tribunal and is for general reference only. It provides answers to such questions as "who is entitled to bring a follow-on action?"; "what is the timeframe to commence the action?" and other practical questions. According to the Guide, any person who is certain to have suffered loss or damage as a result of any act that has been

23 See, HKCC, "Advice on Liquefied Petroleum Gas Supply Arrangement for 15 Public Rental Housing Estates," https://www.compcomm.hk/en/media/press/files/20160908_Competition_Commission_Advisory_Bulletin_en.pdf.

determined to be contravention of a conduct rule, has "a right of action under the CO against (a) any person who has contravened or is contravening the rule; and (b) any person who is, or has been, involved in that contravention." This would seem to suggest that both direct and indirect purchasers have the right to sue. A follow-on action can only be brought after the appeal period for a decision has expired, or an appeal has been determined, and must be brought within three years of the determination.[24]

V. AN ASSESSMENT OF THE COMPLAINTS-ORIENTED APPROACH

From the viewpoint of decision theory, the complaints-oriented approach taken by the HKCC makes a lot of sense in that the sectors and/or the types of conduct that are the subject of more complaints, particularly those by non-competing parties, are generally more likely to have suffered from anti-competitive practices.[25] Furthermore, among the most complained-about conduct reported to the HKCC during the past year, namely cartel conduct, is also the most damaging anti-competitive conduct to society and thus should undoubtedly be the top priority of enforcement. That this seems to be so for the HKCC may be seen in the relatively high proportion of complaints regarding cartel conduct that make it to the Initial Assessment stage (60 out of 192 up to 31 March 2016). The market studies conducted by the HKCC, particularly that on bid-rigging in residential building renovation and maintenance sector, provide significant evidence of cartelized agreements, albeit for the time period right before the commencement of the CO. It is expected that the HKCC will bring formal charges against cartel conduct to the Competition Tribunal some time during the first half of 2017.

Exchange of information is another area worth noting, and one that has received considerable attention from the HKCC. Among the 97 Initial Assessment cases as of March 31, 2016, 39 were related to information exchange among undertakings which may constitute concerted practices. In a speech in late 2016, Rose Webb, Chief Executive of the HKCC, highlighted concerns in relation to the human-resources sector in Hong Kong as the HKCC had become aware of certain exchanges of competitively sensitive information (e.g. salary) among competing firms.

By contrast, while the conduct raised most often in enforcement contacts up to March 2016 was actually RPM (211), only a relatively small fraction (18, or 8.5 percent) have made it to the Initial Assessment stage. However the 18 Initial Assessment RPM issues do still reflect a significant share of the total number of Initial Assessments (97 up to March 2016). Noting the historical prevalence of RPM and the attention paid to it in Hong Kong during the years even prior to the enactment of its CO in 2012[26] and the recent anecdotal evidence (in smartphone retailing and news magazine retailing mentioned earlier), we expect RPM to continue to be an active area of enforcement activity in Hong Kong.

Regarding the possible violations of the Second Conduct Rule of the CO, one cannot help notice that the percentage of alleged abuse of dominance was quite low in the set of the complaints/queries received by the HKCC, namely only 20.6 percent (raised in 190 out of 924). Among the 97 Initial Assessment cases up to March 2016, a slightly higher percentage, 28.9 percent, involve concerns related to the Second Conduct Rule as at least part of the issues under study. In terms of the total number of allegations involved (as each case may involve multiple types of anti-competitive conduct), Second Conduct Rule related practices account for

24 The absence of stand-alone private action under the CO, which primarily resulted as a main compromise the SAR government took before the CO passed the Legislative Council of Hong Kong in 2012, has been criticized by many. It has also led parties to look for other means to privately address competition issues. For example, Loyal Profit International has filed a suit directly to the High Court of Hong Kong alleging anti-competitive conduct by the Travel Industry Council of Hong Kong – in this case under the Companies Ordinance. This important case – which could create an alternative path for stand-alone private competition actions – is to be heard early in 2017. See, e.g. http://kluwercompetitionlawblog.com/2016/11/21/stand-alone-actions-possible-for-anti-competitive-behaviour-in-hong-kong/ and, South China Morning Post, "First case using new Hong Kong competition law set to be heard," http://www.scmp.com/news/hong-kong/law-crime/article/1980860/first-case-using-new-hong-kong-competition-law-set-be-heard.

25 Among the 537 enforcement contacts (up to March 31, 2016) related to the First Conduct Rule, 192 are about cartel conduct, 211 about RPM, 60 for exchange of information. Among the 190 enforcement contacts related to the Second Conduct Rule, 41 are for typing and bundling, 29 for both exclusive dealing and refusal to deal, and 67 for other conduct. Interestingly, 24 enforcement contacts received are for predatory pricing – a practice that many competition experts believe is extremely rare and seldom effective.

26 See, e.g. Lin, P., "Treatments of RPM in Hong Kong," CPI Antitrust Chronicle, 2015.

18.6 percent and 17.8 percent, respectively, of the total number of allegations received from the enforcement contacts by HKCC and the total number of allegations that went into the Initial Assessment phase.[27]

It is difficult to pin down the reasons or considerations behind the lower level of Second Conduct Rule related cases/allegations relative to those applying to the First Conduct Rule. One factor may be that competition law is still new to many businesses in Hong Kong and so perhaps many of the horizontal and vertical agreements now falling under the CO are still being practiced relatively openly. Another possible reason is that complaints over abuse of dominance conduct are often against larger companies. Hence, potential complainants may fear possible retaliation by larger firms whether these large firms are competitors (e.g. for predatory pricing behavior, exclusive dealing that leads to foreclosure, and refusal to deal) or suppliers (e.g. for tie-in and bundling, exclusive dealing or refusal to deal). The newness of the law with few examples to learn from will add to their uncertainty and concerns. Lastly, it may be argued that the threshold for selecting a case to be escalated to the Initial Assessment phase may be higher for SCR related conduct, because it is more difficult to establish a reasonable cause to suspect an abuse of dominance. In other words, prosecuting price-fixing cases is often easier. It will be interesting to see how many and what type of SCR related cases that have been escalated to the Initial Assessment have entered or will enter the Investigation phase.

One may then ask the question, how much enforcement weight should be given to detecting violations of the SCR in Hong Kong. We would like to argue that it may make sense to give greater enforcement attention than might otherwise be suggested for a new authority to the abuse of dominance concern (i.e. Second Conduct Rule) in Hong Kong, because its CO does not have a merger control provision (except for telecoms). Without a strong merger policy to protect against the build-up of high levels of unilateral market power, we can expect the further development of dominant positions in many Hong Kong markets. A strong approach to abusive conduct will attack that conduct by firms with dominant positions currently, rendering that dominance less problematic. However, it will also send a message to potential future merger partners, deterring those mergers that are mainly driven by unilateral market-power enhancing motivations. At least in the longer term, the "complaints-oriented" approach can be supplemented by the consideration that the Second Conduct Rule may need extra enforcement attention (in conducting self-initiated investigation of potential violations and/or market studies) than in a jurisdiction where a strong merger control scheme is also available.

VI. CONCLUDING REMARKS

The period from the passage of the CO up to the end of the first year under the new law has been extremely demanding for the HKCC. In response to these demands the HKCC has, among other things: (i) built up and trained a professional staff; (ii) conducted ambitious education and advocacy programs; (iii) issued many guidelines (and other guidance and policy documents); (iv) investigated a large number of complaints in many areas of competition policy; and (v) taken on a number of matters (such as market studies) that are helping to further define its enforcement approach.

In case selection, it is currently very complaints driven – a sensible approach in our view. As a response to complaints and media reports, the market study on bid-rigging in residential building renovation and maintenance sector gathered strong evidence about bid-rigging, albeit about such conduct prior to the commencement of the CO. This enabled the HKCC to establish bid-rigging as a clear enforcement priority. It also sets the general principle and framework for conducting market studies in the future. Furthermore, the publication of the market study report also showed to the public that the HKCC has the technical and economic tools that can be readily applied to future such and other anti-competitive behavior. The current approach, however, can be supplemented by the consideration that the Second Conduct Rule may need extra enforcement attention than in a jurisdiction where a strong merger control scheme is also available.

27 Calculations are based on the information contained in Figure 1 and Figure 2 of the HKCC Annual Report, 2015/2016.

In short, the HKCC and Hong Kong competition policy are off to a good start in our view. Many important tests lay ahead, perhaps even in the second year under the CO. Two principal questions arise in our minds at this point, to which we are optimistic. First, will the HKCC be prepared to take on powerful business interests when negotiations to resolve issues in a non-adversarial way are unsuccessful? Second, when necessary, can it mount good cases before the Tribunal and win them? Over the longer term, another important question arises: will the HKCC be a strong champion for competition within the Hong Kong government? Will it be able to advocate with other government agencies for the reform of competition-limiting regulations and policies and will it be able stimulate discussions within government on amendments to the CO, to make it an even more complete and effective law.[28]

28 Proposals for eventual reform of the CO are beyond the scope of this paper, but the absence of both a general merger regime and provisions permitting stand-alone private actions both merit attention in our view.

VERTICAL RESTRAINTS VERSUS HORIZONTAL AGREEMENTS IN THE MANUFACTURER-DISTRIBUTOR RELATIONSHIP

BY JOHN JIONG GONG & VANESSA YANHUA ZHANG[1]

I. INTRODUCTION

Since the enforcement of the Anti-Monopoly Law ("AML") in China on August 1, 2008, there have been several high-profile antitrust litigations involving vertical restraints in the manufacturer-distributor relationship. In China vertical restraints are also called vertical monopoly agreements in the context of the AML. In the first and foremost case ruled in 2013, *Beijing Rainbow v. Johnson & Johnson*, the Shanghai Higher Court set precedence of applying the "rule of reason" doctrine in the cases involving vertical monopoly agreements, as opposed to the more common "*per se* illegal" doctrine that is widely applied in situations of vertical monopoly agreements in China. The Shanghai Higher Court emphasized the need for the plaintiff to bear the burden of proof in providing not only evidence of the existence of the agreement behavior (resale price maintenance in this case), but more importantly, also analysis and corresponding evidence that such conduct precludes and limits competition as per Article 14 of the AML.[2] The seventy-one page final verdict from the Shanghai Higher Court specifically mentioned four aspects in the analysis that the plaintiff needs to demonstrate in discerning the legality of a vertical agreement: (1) the relevant market lacks adequate competition; (2) the defendant holds significant market power in the relevant market; (3) the defendant has clear motivation to preclude and restrict competition in maintaining the resale price; and (4) the defendant has indeed achieved its objective of precluding and restricting competition from the perspective of actual outcome.

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2 Article 14 of the AML prohibits any of the following agreements among business operators and their trading parties: (1) fixing the price of commodities for resale to a third party; (2) restricting the minimum price of commodities for resale to a third party; or (3) other monopoly agreements as determined by the Anti-Monopoly Authority under the State Council.

Understandably, the high standard established in the *Beijing Rainbow v. Johnson & Johnson* case vis-à-vis the "*per se* illegal" doctrine that was typically used in previous situations of vertical monopoly agreements greatly raises the bar for the distributor to resolve conflicts with its producer in the court of law, although the distributor can also resort to the administrative antitrust enforcement via the National Development and Reform Commission ("NDRC"), which is one of the three antitrust law enforcement agencies in China and is responsible for going after price-related antitrust violations. Notably, the NDRC has repeatedly maintained its position that resale price maintenance ("RPM") is a *per-se* illegal matter and particularly its own enforcement actions should not be influenced by the court rulings. This generates an interesting legal landscape where the judicial and the administrative wings of the AML enforcement have different legal standards, which may provide incentives for related litigants to take different legal approaches. Cases like this tend to blur the boundary between vertical and horizontal monopoly agreements in manufacturer-distributor relationships.

II. CASE BACKGROUND

A recent lawsuit brought against Panasonic Electronics at the Shanghai No. 1 Intermediate People's Court is a case in point.[3] Panasonic Electronics in China sells a set of factory automation control equipment including mostly programmable logic controllers ("PLC"), low voltage electric transformers and generic sensors. The company's contractual relationship with its distributors covers a critical charter document that regulates the management of its end customers. The document, called "Panasonic Eastern China End Customer Management Charter," essentially establishes a client protection system, whereby important and quality clients are protected from being approached by other distributors who previously do not have a business relationship with these clients. When a distributor approaches a prospective client, he needs to first check with a database regarding these clients' information, to make sure this particular prospective client is not in the list already belonging to another distributor. The protection is essentially in the form of a RPM practice where other distributors' quoting prices to a protected client have to be at least 15 percent higher than the standard distributor-suggested-price from Panasonic. This mechanism makes sure that the quoted price of an unrelated distributor is uncompetitive, and thus protects the incumbent distributor.

The client protection database is constantly updated such that non-active clients for a period of time are downgraded to another database including a list of prospective clients. Client entries in the second prospective client database are entered by Panasonic's distributors, who are entitled to protection for a maximum of three months. That means other distributors are not supposed to approach those prospective clients in this list. If no transaction takes place after three months, this client is taken off the list and becomes available to any distributor.

In 2014, the plaintiff, Rijin Electric Co., which is one of Panasonic's regional distributors, brought Panasonic together with two other distributors to court for allegedly forming a monopoly agreement for a market division scheme. The major reason behind the allegation is that the plaintiff was penalized by Panasonic for violating the business practice regulation which was mutually agreed upon and articulated in the End Customer Management Charter. Initially the plaintiff was vague on what particular type of monopoly agreement it was referring to, specifically with respect to the vertical monopoly agreement as referred to Article 14 of the AML or with respect to the horizontal monopoly agreement as referred to Article 13 of the AML.[4] Later on, the plaintiff switched to a horizontal monopoly agreement allegation during the rest of the trial. The court clarified in its decision that the case involved an action whose legality belongs to the realm of vertical monopoly agreement instead, and dismissed all anti-competitive allegations and damage claims brought by the plaintiff.

3 *Shanghai Rijin v. Panasonic Electronics*, Civil Judgment of Shanghai No. 1 Intermediate People's Court, (2014) HU YI ZHONG MIN WU (ZHI) CHU ZI No. 120, June 29, 2016, available at: http://cclp.sjtu.edu.cn/Show.aspx?info_lb=672&info_id=3943&flag=648.

4 Article 13 of the AML prohibits any of the following monopoly agreements among the competing business operators: (1) fixing or changing prices of commodities; (2) limiting the output or sales of commodities; (3) dividing the sales market or the raw material procurement market; (4) restricting the purchase of new technology or new facilities or the development of new technology or new products; (5) making boycott transactions; (6) other monopoly agreements as determined by the Anti-Monopoly Authority under the State Council. For the purposes of this Law, "monopoly agreements" refer to agreements, decisions or other concerted actions which eliminate or restrict competition.

III. CASE ANALYSIS

The Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law in Civil Dispute Cases Arising out of Monopolistic Conduct ("Provisions") have allocated a higher burden of proof on defendants under horizontal monopoly agreements than under vertical monopoly agreements.[5] Article 7 of the Provisions relates to monopoly agreements such as horizontal price-fixing agreements or other cartel conducts prohibited by Article 13 of the AML, and provides that once a plaintiff proves the existence of such an agreement, that agreement will be presumed to have the effect of eliminating or restricting competition unless the defendant can provide evidence rebutting this presumption. Apparently, the approach of horizontal monopoly agreements that the plaintiff has chosen aimed to move more burden of proof to the defendant, no matter if it is relevant to the case or not. Regardless of claims the plaintiff brought to the court, the dispute resolved around the manufacturer-distributor relationship. Therefore, the defendant's legal team offered a vertical restraints defense during the first court appearance. The economics expert team postulated several arguments that the pricing requirement of 15 percent premium to protected clients does not constitute the RPM practice, and the actual outcome of the practice is far from a complete market division.

First, the client protection database does not apply to all of the distributors' clients, but only applies to those clients who are important and of high quality. That means only these clients who show a track record of repeated purchases in significant amounts are protected. Thus only a subset of the market is singled out for protection, resulting in an incomplete division of the market, if it can be called "market division" at all. Consequently, the so-called RPM practice does not apply to all clients in the market, but only applies to a small subset. A distributor is free to quote its own prices to prospective clients who are not in the client protection list. More importantly, the list of protected clients in the database keeps changing overtime. If a client places no order for a period of time, usually after three months, he would be eliminated from the list and become available to other distributors.

Second, the 15-percent overpricing practice does not withstand the "rule-of-reason" analysis under the analytic framework established in the *Beijing Rainbow v. Johnson & Johnson* case. That is, the relevant market for PLC and other related electronics equipment is highly competitive where the HHIs were well below 1400 for three consecutive years from 2011 to 2013, while Panasonic's market share was well below 10 percent, entailing hardly any significant market power. On the motivation issue, Panasonic's implementation of a client protection system clearly has merits of preventing distributors' free-riding behavior as opposed to the intention to preclude and limit competition. This is because the sale of PLC and related electronics equipment involves a fair amount of pre-sales and post-sales activities whose costs can sometimes run as much as 15 percent of the total costs. Typically, the distributor needs to understand the equipment's intended working environment and its particular application, work out an involved specification document, add or modify the equipment's software, install the equipment, conduct testing and offer other after-sales services. In a nutshell the distributor is offering a customized solution as opposed to simply reselling PLC equipment. In terms of the actual effect of precluding and limiting competition, the total impact of the defendant's practice on the entire market competition is minimal at best. This is because the impact on the intra-brand competition is modest, but on the contrary, more likely conducive to competition among its distributors, let alone on the inter-brand competition with the defendant's less than 10 percent market share.

Understandably these are fairly strong pro-RPM arguments very much in favor of the defendant. Facing the probable prospect of losing the lawsuit, the plaintiff's legal team switched gear in the second court appearance to pursue the horizontal monopoly agreements allegation under Article 13 of the AML. The plaintiff's team decided to take this avenue against the presiding judge's warning ahead of the second court appearance that a horizontal relationship for a manufacturer-distributor dispute case may not be relevant nor appropriate to a fundamentally upstream-downstream relationship. The plaintiff insisted that the defendant played a leading role in organizing a horizontal monopoly agreement among its distributors via the vehicle of the End Customer Management

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5 Article 7 of the Provisions states that "when the alleged monopolistic conduct is found to be the monopolistic agreement stipulated in Article 13 (1) to (5) of the AML, the defendant shall undertake the burden of proof that the alleged monopolistic agreement doesn't have the effect of eliminating or restricting competition." See the Supreme People's Court, *Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law in Civil Dispute Cases Arising out of Monopolistic Conduct*, May 8, 2012, Chinese version available at: http://www.chinacourt.org/law/detail/2012/05/id/145752.shtml. The significance of the Provisions is discussed in Supreme People's Court Judge Li Zhu's article. See Li Zhu, New Developments in Civil Antitrust Litigation in China, Antitrust Chronicle, January 2012, available at: https://www.competitionpolicyinternational.com/assets/Uploads/ZhuLiJAN-4.pdf.

Charter, and was effectively engaged in forming a cartel for market division, which is explicitly prohibited in a statutory manner by Article 13 (3) of the AML. The two distributor co-defendants were alleged as participants of this cartel.

In the second expert witness report to rebut the plaintiff's horizontal monopoly agreement position, there were essentially two arguments. First, the End Customer Management Charter at issue was not an agreement jointly signed among the defendant's distributors, but rather an agreement signed individually and mutually between the defendant and its distributors. In other words, it regulated a vertical contractual relationship as opposed to a horizontal relationship that is typically characterized by competition among signing parties. Distributors had not been previously engaged in mutual discussions or negotiations in formulating the agreement, nor had they provided any inputs into the final agreement draft. Therefore, Article 13 of the AML, which is pointedly concerned with horizontal monopoly agreement, simply does not apply to this case. Second, Article 13(3) of the AML indeed prohibits market division. But the statutory meaning of the market in this instance refers to the entire relevant market that encompassed other competing brands from competing firms. Therefore, even if a subset of market division within one brand indeed holds, it did not constitute a market division in the relevant market that the statutory language in Article 13(3) refers to. Therefore, this kind of client protection practice was not illegal. On the contrary, it was a common practice in the defendant's industry around the world.

On June 29, 2016, the court entered a judgment, which dismissed all of the plaintiff's allegations against the defendants. The judge agreed with the defendants' position that Article 13 of the AML did not apply in this case. He further wrote in the verdict that even if a horizontal agreement among parallel members (meaning distributors) within a vertical relationship possibly precluded and limited intra-brand competition, meaning the competition among distributors of the same producer, such an agreement might not extend to harm inter-brand competition of the entire market. Thus a horizontal agreement within a vertical relationship may not be such a kind of horizontal monopoly agreement prohibited in Article 13 of the AML. He further went on to state that only competing parties owning different brands and forming a horizontal agreement could possibly preclude and limit competition, and Article 13 of the AML should only apply to those circumstances.

It might be arguable in the judge's position that horizontal monopoly agreements meeting Article 13's definition could only exist among competing parties owning different brands. Moreover, the court's position might be pointedly in conflict with the approach taken by the NDRC. For example, in 2013 the local branch of the NDRC in Hubei Province found that FAW Volkswagen, which is an automobile joint venture company in China, organized ten local dealers in the city of Wuhan, Hubei Province, to jointly sign an agreement in writing that essentially fixed prices for new Audi cars, auto parts and components and car repairs.[6] The Hubei branch of the NDRC ruled that FAW Volkswagen violated Article 13 of the AML and fined FAW Volkswagen and all the signatory dealer parties. Certainly this is not the first time in China that the judicial and the administrative antitrust law enforcement entities took inconsistent legal positions.

IV. CONCLUSION

The core matter in this case is that the End Customer Management Charter in no way qualifies as a horizontal monopoly agreement, for various reasons we have articulated above. Thus, Article 13 of the AML simply should not apply. Even though the court reached the same conclusion as ours, the reasoning behind it however was quite different. The court clearly accepted it as a horizontal monopoly agreement, but stated such an agreement was within a vertical relationship and within the same brand, and is thus not the same kind of horizontal monopoly agreement that Article 13 is intended to outlaw.

The ruling in this case begs the question as to how a manufacturer-distributor conflict shall be handled by courts in the future as to whether it should be resolved under the framework of Article 13 or Article 14 of the AML. This question probably applies to the competition agencies as well. This ruling appears to leave the impression that any manufacturer-initiated restraint to manage its distributors falls in danger of becoming a horizontal monopoly agreement, albeit within a vertical relationship.

6 Decision of Administrative Penalty (*FAW Volkswagen*), E JIA JIAN CHU [2014] No. 14, Hubei Province Price Bureau, August 18, 2014, http://www.hbpic.gov.cn/zwgk/gfwj/xzxkhcf/201701/t20170110_23774.html.

In our opinion, conflicts arising from manufacturer-distributor relationships could be complex, and may not always fall into the realm of a vertical relationship, and do not always have to be necessarily regulated by Article 14 of the AML. In the *Panasonic* case, we take the position that Article 14 should apply, while Article 13 should apply in the *FAW Volkswagen* case. But the four-point analytic framework established in the *Beijing Rainbow v. Johnson & Johnson* case[7] is decidedly fundamental to determine the legality of a vertical monopoly agreement.

7 *Beijing Rainbow v. Johnson & Johnson*, Civil Decision of Shanghai Higher People's Court, (2012) HU GAO MIN SAN (ZHI) ZHONG ZI No. 63, August 1, 2013, available at: http://ipr.court.gov.cn/sh/ld/201309/t20130927_157023.html.

NDRC'S ENFORCEMENT IN 2016

BY SUSAN NING, KATE PENG, SIBO GAO & TING GONG[1]

   

I. INTRODUCTION

Since the enactment of the Anti-monopoly Law ("AML") in 2008, China's AML enforcement has gained momentum, especially over the past three years. This development makes China one of the most important jurisdictions to which companies need to pay close attention.

Under the AML, the enforcement activities are shared by three Chinese agencies, based on the type of targeted behaviors. Specifically, the Ministry of Commerce ("MOFCOM") is entrusted with the task of reviewing proposed mergers; the National Development and Reform Commission ("NDRC") and the State Administration for Industry and Commerce ("SAIC") are in charge of regulating non-merger monopoly behaviors, including monopoly agreements and abuse of dominance. Furthermore, the NDRC is responsible for regulating price related monopoly behavior and the SAIC is responsible for regulating non-price related monopoly behavior.

2016 was an intensive year for the NDRC. Looking back, the NDRC's work mainly focused on i) AML enforcement against monopoly behavior by undertakings, ii) AML enforcement against abuse of administrative power by government and the introduction of the fair competition review system; and iii) promulgation of six antitrust guidelines.

With respect to the NDRC's enforcement against undertakings in 2016, as disclosed at a conference by Deputy Director General Li Qing of Price Supervision and Anti-monopoly Bureau ("PSAMB") of the NDRC, the authority and its local agencies investigated a dozen price related monopoly cases, mainly in the pharmaceutical, automobile, public utility and consumable product industries.[2] These cases mainly concern horizontal monopoly agreements and vertical monopoly agreements. In particular, 2016 has seen some new developments in NDRC investigations — one is the concerted action being identified in a cartel case and the other is non-price related vertical monopoly

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2 See Chinese news report, available at: http://www.sccom.gov.cn/bwxx/-/articles/v/3027264.shtml.

agreement which facilitates or strengthens the effect of resale price maintenance ("RPM"). As to the abusive behaviors of dominant firms, there is only one closed case by Hubei Price Bureau (a local DRC) concerning five natural gas companies. In the meantime, according to publicly available information, the NDRC is still in the process of investigating several technology companies for their suspected abuses of IP rights.

Generally speaking, the cases closed in 2016 have shown some industry specific characteristics. Alongside the comprehensive reform in the pharmaceutical industry and auto industry, the NDRC and its local agencies have been stepping up their enforcement efforts. We expect that the pharmaceutical and automobile industries will continue to be the NDRC's enforcement priorities in 2017 and onwards. In the meantime, for the consumable industry and the medical device industry, we have seen the NDRC and its local agencies becoming more active in enforcing Article 14 of the AML, aiming at correct the long-standing RPM practice in the industries.

In addition, the NDRC also made a great effort in the introduction of the fair competition review system. The fair competition review system is regarded as *ex-ante* and a systematic measure to prevent abusive conduct by administrative organizations. The NDRC's active participation in the mechanism, alongside the NDRC's enforcement against abuse of administrative power, embodies the NDRC's determination to correct the government's monopolistic behavior. As disclosed at a conference by the Deputy Director General Li Qing of the NDRC, the authority and its local agencies completed 17 abuse cases of administrative power, among which the administrative authorities in 15 cases have rectified their abusive behavior.[3]

In terms of legislative efforts, the NDRC, under the authority of the Anti-monopoly Commission of the State Council, was occupied with the drafting of the six antitrust guidelines on the leniency program, commitment program, exemption procedures, calculation of fines and illegal gains and for the auto sector and IP related area. These draft guidelines have been published by the NDRC to solicit public comments, and the final versions are expected to be issued by the Anti-monopoly Commission in 2017. These guidelines are expected to provide more legal certainty in the agencies' antitrust enforcement activities. Most of the above mentioned guidelines are procedural rules, while two concern the auto sector and IP related area in particular. This reflects the AML enforcement agencies' special attention to the auto sector and IP antitrust enforcement. In addition, it also, to some extent, reflects the Chinese regulators' efforts to learn from the most mature jurisdictions and adapt such experiences to China's unique context. At last, in light of the NDRC's efforts in 2016, we will present our speculation of the NDRC's enforcement priorities in year 2017 and the future.

II. AML ENFORCEMENT AGAINST UNDERKTAKINGS

A. Pharmaceutical Industry

In 2011, the NDRC investigated and imposed fines on two compound reserpine API (Active Pharmaceutical Ingredient) manufacturers for their monopolistic behavior.[4] Afterwards, the NDRC was reported to have paid close attention to the pharmaceutical and medical device industries in 2013.[5] In March 2014, the NDRC issued questionnaires to some pharmaceutical companies for an informal inquiry.

In 2015, drug price reform began. The Chinese government issued the *Opinions on Promoting the Drug Pricing Reform* to scrap the "government-set prices" for most pharmaceuticals and let the drug manufacturers set the prices according to market mechanisms.[6] On this backdrop, the NDRC ordered its local agencies to immediately launch a half-a-year pharmaceutical pricing inspection

3 See Chinese news report, available at: http://www.sccom.gov.cn/bwxx/-/articles/v/3027264.shtml.

4 See the NDRC's news release, available at: http://jjs.ndrc.gov.cn/fjgld/201203/t20120306_465386.html.

5 See Chinese news report, available at: http://news.qq.com/a/20131125/000933.htm.

6 See the NDRC's official notice, available at: http://www.sdpc.gov.cn/zcfb/zcfbtz/201505/t20150505_690664.html.

to ensure the smooth implementation of the drug pricing reforms.[7] The targets of the inspection are pharmaceutical manufacturers and operators, medical institutions, centers for disease control and prevention, blood banks, centralized purchasing platforms of drugs, etc., to see if these operators take the opportunity of drug pricing reform to conduct behavior that would distort the market prices.

Approaching 2016, the NDRC's attention to the pharmaceutical industry continued. In early 2016, the NDRC listed the pharmaceutical industry as one of its antitrust enforcement priorities for the year.[8] Following that, the NDRC issued questionnaires to pharmaceutical companies and medical device companies for a general survey.[9] In June 2016, having noticed that there were some price related illegal behavior in the drug and API markets, which affected fair competition, increased the patients' burden and aroused objections from consumers and enterprises, the NDRC decided to initiate another round of national special inspections into drug prices.[10] In particular, behaviors to be investigated and punished include:

(i) Whether enterprises manufacturing and operating APIs or drugs reach and implement monopoly agreements, and whether industry associations organize relevant enterprises to reach and implement monopoly agreements; and

(ii) Whether enterprises manufacturing and operating APIs or drugs abuse dominant market position to sell APIs or drugs at an unfairly high price.

In August, 2016, it was reported that the NDRC distributed a second round of questionnaires to pharmaceutical companies and medical device companies and to short-listed companies that had caught the agency's attention during the first round.[11]

As a result of several rounds of surveys and inspections conducted by the NDRC, the agency investigated and issued administrative penalty decisions on two cases in 2016. As drugs concern people's livelihood, and in order to facilitate the drug pricing reform, the pharmaceutical industry is likely to be listed as one of the NDRC's enforcement priorities in 2017 and the antitrust enforcement of the pharmaceutical industry is likely to become the NDRC's "new normal."

1. *Allopurinol* Case[12]

On March 2, 2016, the NDRC published its decision to fine five domestic pharmaceutical companies, i.e. Chongqing Qingyang Pharmaceutical Co., Ltd. ("Chongqing Qingyang") and its affiliated sales company Chongqing Datong Pharmaceutical Co., Ltd. ("Chongqing Datong"), Shimao Tianjie Pharmaceutical (Jiangsu) Co., Ltd. ("Shimao Tianjie"), Shanghai Xinyi United Medical Materials Co., Ltd. ("Shanghai Xinyi") and its exclusive distributor Shangqiu Huajie Pharmaceutical Co., Ltd. ("Shangqiu Huajie"), for a total amount of almost RMB 4 million. These companies were found to have reached and implemented monopoly agreements on increasing the price of allopurinol tablets together, allocating sales market of allopurinol tablets and agreements to bid in designated areas in the period between April 2014 and September 2015.

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7 See the NDRC's official notice, available at: http://jjs.ndrc.gov.cn/zcfg/201505/t20150505_690681.html.

8 See the NDRC, *Priorities in Price Supervision and Anti-monopoly Working Arrangements in 2016*, China Price Supervision and Anti-monopoly, Page 5, Volume 2, 2016.

9 See Chinese news report, available at: http://opinion.caixin.com/2016-08-24/100981127.html.

10 See the NDRC's official notice, available at: http://jjs.ndrc.gov.cn/zcfg/201605/t20160527_805088.html.

11 See news report, available at: https://app.parr-global.com/intelligence/view/1461170.

12 See the NDRC's administrative penalty decision in Chinese, available at: http://jjs.ndrc.gov.cn/fjgld/201602/t20160202_774107.html, http://jjs.ndrc.gov.cn/fjgld/201602/t20160202_774108.html, http://jjs.ndrc.gov.cn/fjgld/201602/t20160202_774110.html, http://jjs.ndrc.gov.cn/fjgld/201602/t20160202_774113.html.

As Chongqing Qingyang, Shanghai Xinyi and Shimao Tianjie were the only three manufacturers of allopurinol tablets in the Chinese market since 2014, the NDRC concluded that the five companies' monopolistic conduct seriously eliminated and restricted competition within the market. Therefore, Chongqing Qingyang, together with Chongqing Datong, were fined 8 percent of their sales revenue in 2014; Shimao Tianjie, Shanghai Xinyi and Shangqiu Huajie were fined 5 percent of their sale revenue in 2014 due to their cooperation in the investigation.

2. *Estazolam* Case[13]

On July 27, 2016, the NDRC published its final decision regarding the *Estazolam* case. In that case, three local pharmaceutical companies, i.e. Huazhong Pharmaceutical Co., Ltd. ("Huazhong Pharmaceutical"), Shandong Xinyi Pharmaceutical Co., Ltd. ("Shandong Xinyi"), and Changzhou Siyao Pharmaceutical Co., Ltd. ("Changzhou Siyao"), were fined RMB 2.6 million in total for reaching and implementing monopoly agreements on jointly boycotting the sales of estazolam API and on raising the prices of estazolam tablets.

According to the final decisions published, the NDRC found that following the Chinese government's announcement of the low-priced drug policy in 2014, the three companies concluded and implemented monopoly agreements by means of meetings, phone calls, text messages and emails about the estazolam API market to jointly boycott other estazolam tablet manufacturers and to fix or change the prices in the estazolam tablet market. The NDRC found that between September and October 2014, the three companies held meetings in Zhengzhou City of Henan Province, where they reached a consensus on the following two points: (1) estazolam APIs shall be for internal consumption of these three companies and they shall refuse supply of estazolam APIs to other business operators, and (2) the three companies shall raise their respective estazolam tablet prices. In addition, the NDRC found that after October 2014, these companies implemented the monopoly agreement by gradually ceasing the supply of estazolam APIs to other business operators and raising the price of estazolam tablet through companies' notice of price adjustment at similar timings. It is worth noting that although Changzhou Siyao did not express its consent with the joint boycott and price raising arrangement, the NDRC nonetheless identified it as a participant to the cartel. The NDRC found that Changzhou Siyao did not raise any objection to the above arrangement, nor did it report the monopoly agreement to the AML enforcement agencies. In this situation, the NDRC was of the view that the companies communicated with each other. Such communication together with the subsequent consistent actions constitutes "concerted action," which is a form of monopoly agreement in violation of Article 13 of the AML. This is the first case where the AML enforcement agency found that undertakings had engaged in "concerted actions."

In the end, the NDRC decided that since Huazhong Pharmaceutical played a leading role in the events, the company should be imposed a fine of CNY 1,571,829, amounting to 7 percent of its annual estazolam tablet sales in 2015; since Shandong Xinyi actively cooperated with the NDRC in the investigations, which constituted meritorious conduct, it received a mitigated penalty and its fine was reduced to 2.5 percent (CNY 547,563) of its annual estazolam tablet sales in 2015; for Changzhou Siyao, since it acted merely as a follower and had actively and voluntarily rectified its wrongdoings, the NDRC fined the company 3 percent (CNY 484,431) of its annual estazolam tablet sales in 2015.

B. Medical Device Industry

The NDRC has been keeping a close eye on the medical device industry since 2013. In both 2015[14] and 2016,[15] the NDRC listed the medical device industry as one of its enforcement priorities and distributed questionnaires to medical device companies for industry survey.

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13 See the NDRC's administrative penalty decision in Chinese, available at: http://jjs.ndrc.gov.cn/fjgld/201607/t20160727_812579.html, http://jjs.ndrc.gov.cn/fjgld/201607/t20160727_812583.html, http://jjs.ndrc.gov.cn/fjgld/201607/t20160727_812587.html.

14 See KWM Client Alert, *Highlights of NDRC's Antitrust Enforcement in 2016*, available at: http://www.kwm.com/en/cn/knowledge/insights/2016-ndrc-legal-highlights-of-the-antitrust-law-20160322.

15 See *supra* note 8.

In December 2016, the NDRC finally issued its administrative penalty decisions on its investigation against Medtronic (Shanghai) Management ("Medtronic").[16] This case is the first case in the medical device industry where the NDRC imposed a fine according to publicly available information. According to DG Zhang Handong of the PSAMB, in the recent years, the NDRC has been highly concerned about the market competition in the medical and health field and has conducted in depth studies and research regarding monopolistic behavior, competition-restricting behavior and excessively high prices, etc.[17] It is understood that in 2017, the NDRC will likely list the medical device industry as one of its enforcement priorities.

1. *Medtronic* Case

On December 9, 2016, the NDRC posted its penalty decision on Medtronic over price monopoly agreements in relation to medical devices for cardiovascular diseases, retroactive therapies and diabetes in China.

In the decision, the NDRC concluded that Medtronic entered into and implemented RPM agreements beginning in 2014 or earlier, for the purpose of fixing or restricting resale prices of relevant products with its transaction counterparts, which include a platform distributor and first-level distributors.

Specifically, the content of the monopoly agreements include:

(i) Directly fixing the resale price by circulating the price lists for relevant products at each resale level;

(ii) Fixing the platform distributors' gross profit rates, thereby indirectly fixing the platform distributors' resale prices;

(iii) Restricting the distributors' minimum bid prices; and

(iiii) Restricting the minimum resale price to hospitals.

The NDRC found that the monopoly agreements on fixing and restricting the resale prices had been implemented by the platform distributors and the first-level distributors. Moreover, the NDRC found that Medtronic also took such measures as restricting the distributors' target customers and sale regions, prohibiting distributors from selling competing products, etc., to further reinforce the effect of the distributors' implementation of the monopoly agreements. The NDRC is of the view that the high-value consumable and implantable medical device market has relatively high technology barriers; the fair competition among distributors is the key to ensure reasonable market prices, considering that most medical device manufacturers took the resale model. However, the above non-price restrictions restrict the competition among Medtronic's distributors and thereby harm consumers' interests.

Regarding the influence on the competition among distributors, the NDRC found that Medtronic's behavior also restricted the inter-brand competition in the medical device industry. In particular, the NDRC found that the competition in the medical device industry is not sufficient, to the extent that consumers have limited choices of different brands of medical devices. In that case, considering that Medtronic is the leader in cardiovascular diseases, retroactive therapies and diabetes market, the company's RPM arrangement and the prohibition of its distributors from selling competing products further strengthened the adverse effects on market competition. Moreover, as Medtronic restricted the minimum resale price, bidding price and minimum price to hospitals, the company harmed end-customers' legitimate interests and increased the burden on patients.

In light of the above, the NDRC concluded that Medtronic violated Article 14(1) and Article 14(2) of the AML, which prohibit undertakings from fixing the resale price or from restricting the minimum resale price. Considering that Medtronic's illegal behavior

16 See the NDRC's administrative penalty decision in Chinese, available at: http://jjs.ndrc.gov.cn/fjgld/201612/t20161209_829716.html.

17 See Xinhuanet news report, available at: http://news.xinhuanet.com/legal/2016-12/08/c_1120079132.htm.

involved the wholesale process from the platform distributor, distributor to end-user, and that Medtronic also imposed comprehensive vertical restrictions in relation to not only to resale prices, but also to sale targets, regions and the sale of competing products, the NDRC decided to fine the company 4 percent of its sales revenue generated in 2015 (i.e. RMB 118.52 million).

In the *Medtronic* case, the NDRC expressly addressed how the non-price vertical restrictions facilitated the implementation of the RPM arrangement, which indicates the NDRC's intention to strengthen the enforcement against other types of vertical restrictions. Although non-price vertical restrictions are not expressly prohibited by the AML, theoretically they could be caught by Article 14(3), a catch-all clause of the law. The AML enforcement agencies have never invoked this clause up to the present. However, in the draft antitrust guidelines for the auto sector and IP related area, there is a list of specific non-price vertical restrictions that the AML enforcement agencies may find problematic. This shows that non-price vertical restrictions have come into the sight of the enforcement agencies. We expect to see more cases like *Medtronic* where non-price vertical restrictions would be addressed, and moreover, cases where non-price vertical restrictions become the subject matter of enforcement activities.

C. Automobile Sector and the Industries of Related Products

The automobile sector and the industries of related products have always been the focus of the NDRC's enforcement. It is reported that in 2012, the NDRC engaged the China Automobile Dealers Association ("CADA") to conduct studies and research regarding whether there was any AML violation in the automobile industry.[18] In the same year, through the CADA's platform, Deputy Director General Mr. Lu Yanchun of the PSAMB disclosed that the NDRC planned to reinforce its enforcement efforts in the automobile industry and had identified its enforcement priorities on the whole car sale price, the after-sales service and the practice of refusal to deal.[19] In 2013, Mr. Lu further disclosed that the NDRC had investigated a case where the distributors of a certain car brand had convened meetings to discuss the cars' sale prices in 2011.[20]

In 2014, with the exposure of "parts-to-whole price ratio" of a car, the antitrust issues in the automobile sector first came to public attention. A few months later, the NDRC sanctioned several automobile manufacturers and auto parts manufacturers[21] for more than RMB 2 billion in total, which further pushed the automobile and related products industries to the forefront of AML enforcement.

Thereafter, the NDRC, the MOT and the SAIC, together with other authorities, successively publicized a series of policies in furtherance of the institutionalization and legalization of antitrust practice in the automotive industry, including the ceasing of brand authorization registration for auto distributors,[22] the publication of *Guiding Opinions on Promoting the Transformation and Upgrading of the Auto Maintenance Industry to Improve Service Quality, Administrative Measures on the Publication of Auto Maintenance and Repair Technical Information*, etc. Moreover, on March 23, 2016, the NDRC released the draft Antitrust Guidelines for Auto Sector ("Draft Auto Guidelines"), seeking public comments.

In 2016, the NDRC listed the auto and component part industry as one of its enforcement priorities. On April 15, 2016, the

18 See news report, available at: http://www.chyxx.com/news/2013/0814/216346.html.

19 Ibid.

20 Ibid.

21 In 2014 and 2015, cases in relation to the automobile and component parts industries include i) the cartel investigation against twelve Japanese auto parts manufacturers, ii) the cartel investigation against four BMW dealers in Hubei Province, iii) the investigation against FAW-VW Audi and eight dealers in Hubei Province, iv) the investigation against Chrysler and eight dealers in Shanghai, v) the investigation against Benz and several dealers in Jiangsu Province, and vi) the investigation against Nissan and 17 dealers in Guangdong Province.

22 Previously, the automobile manufacturer or its general distributor were required to file certain dealer-related documents, including the brand authorization agreement, with the SAIC before the dealers could apply for business registration at the local AIC. The business scope as indicated on the dealer's business license would be "brand specific automobile sales." Once registered at a local AIC, a dealer could not engage in the sales of other brands of automobiles, as this would be outside its business scope, which would be a violation of the Company Law.

NDRC's local agency in Shanghai, the Shanghai Price Bureau, published an administrative penalty decision against Shanghai Hankook Tire Sales Co., Ltd. ("Shanghai Hankook")[23] and on December 23, 2016, Shanghai Price Bureau issued another administrative penalty decision against SAIC-GM Sales Co., Ltd. ("SGM").[24]

1. *Hankook Tire* Case

The Shanghai Price Bureau found that Shanghai Hankook and its distributors reached monopoly agreements that restricted the minimum resale price of commodities to a third party. Further, the Shanghai Price Bureau found that the monopoly agreements had been implemented as Shanghai Hankook drafted and issued the minimum price list for tires of trucks and buses, collected deposits from distributors for ensuring the market "order" and issued notices to regulate minimum sale prices of tires for passenger cars.

In light of the above, the Shanghai Price Bureau concluded that Shanghai Hankook violated Article 14(2) of the AML and Article 8(2) of the Rules on Anti-Price Monopoly, which prohibit undertakings from reaching and implementing monopoly agreements that "restrict the minimum resale price of commodities to a third party" with transaction counterparts. However, considering that Shanghai Hankook had already removed the clause that restricted the minimum resale price from the Franchised Distribution Agreement before the initiation of the investigation, proactively rectified certain illegal conduct, actively cooperated with the investigation, voluntarily submitted certain evidence that the agency did not know and refunded the deposits, the Shanghai Price Bureau imposed a lighter penalty, which was one percent of Shanghai Hankook's sales in 2014 generated from the relevant market, amounting to about RMB 2.17 million.

2. *SGM* Case

On December 23, 2017, the Shanghai Price Bureau issued its administrative penalty decision against SGM for its engagement in a vertical monopoly agreement that restricted its Shanghai distributors' minimum resale price of Cadillac SRX, Chevrolet TRAX, Buick Verano, Excelle GT, etc.

The agency found that SGM circulated documents, such as a Regional Price Notice, Market Competition Updates and Notice of Price Guidance, to set the minimum resale price restrictions and monitored the distributors' compliance through engaging a third party to conduct secret inspections, online surveys, etc. In addition, for those distributors that did not follow SGM's price guidance, the company would, by publishing the secret inspection report or interviewing the relevant distributors, ask the distributors to adjust their sale price; or the company may even punish the non-compliant distributors by ceasing to supply popular cars, imposing fines on the distributors or deducting rebates.

In light of the above, the Shanghai Price Bureau concluded that SGM violated Article 14(2) of the AML and Article 8(2) of Rules on Anti-Price Monopoly that prohibits undertakings from reaching and implementing monopoly agreements that restrict the minimum resale price of commodities. The Shanghai Price Bureau found that SGM's behavior deprived the distributors' right to adjust prices in accordance with the market competition status and resulted in end consumers paying higher prices than should have been paid under competitive markets. Therefore, the monopoly agreement eliminated and restricted the market competition and harmed the interests of consumers and the public.

By considering the nature and the degree of SGM's illegal conduct, the Shanghai Price Bureau fined SGM four percent of its relevant sales revenue generated in 2015, i.e. about RMB 201 million.

23 See Shanghai Price Bureau's administrative penalty decision, available at: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/23432.htm.

24 See Shanghai Price Bureau's administrative penalty decision, available at: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/25286.htm.

3. Draft Auto Guidelines

Compared to the newly promulgated policies in the automotive industry as mentioned above, the Draft Auto Guidelines, which are the first comprehensive industrial antitrust guidelines, have made a great breakthrough by covering a wide scope of issues.

The Draft Auto Guidelines set forth a series of business arrangements in the automotive sales market and aftermarket that may constitute vertical monopoly agreements or abuse of dominant market position. In analyzing these arrangements, the Draft Auto Guidelines require an evaluation of both pro-efficient effect and anti-competitive effect. Also, the Draft Auto Guidelines put forward presumptive exemptions for vertical agreements that are evidenced in practice to be pro-efficient without seriously restricting competition.[25] As for vertical agreements that fall outside the presumptive exemption, the Draft Auto Guidelines require a case-by-case analysis on whether it meets the statutory requirements specified in Article 15. In addition, it is worth noting that for the first time, the Draft Auto Guidelines clearly identify non-price vertical restrictions, e.g. territorial and customer restrictions, which may constitute monopoly agreements. This would bring more positive effect in furthering the corporation's efforts on antitrust compliance by providing more clarity.

Moreover, the Draft Auto Guidelines provide for rights and obligations of auto suppliers, component part suppliers and auto distributors, and cover multiple levels of the industry chain, including production, wholesale, retail and aftermarket, etc. The Draft Auto Guidelines introduce a series of new concepts, including significant market power, single branding in the aftermarket, cumulative effect, passive sales, intermediaries and genuine subcontracting agreements. Some of these concepts are broadly employed in well-developed antitrust jurisdictions; while for Chinese antitrust-related legislations, this will be the first time these concepts will be recognized. The promulgation of the Antitrust Guidelines for Auto Sector will have a far-reaching influence on China's antitrust practice in the days to come.

D. Consumable Product Industry

The consumable product industry has always been one of the areas to which the NDRC pays attention, as it concerns people's livelihood. In 2016, the NDRC and its local agencies investigated several cases concerning companies' engagement in vertical monopoly agreements. For example, the Shanghai Price Bureau investigated and fined two cases in relation to household electrical appliances and dairy products during the past year for RPM arrangements.

In January 2017, the NDRC warned household electrical appliance manufacturers against behaviors of engaging in horizontal monopoly agreements, vertical monopoly agreements, abusing dominant market position, artificially pushing up prices, predatory pricing and price fraud.[26] It is understood that the NDRC will continuously monitor the manufacturers' behavior in the consumable product industry

1. Shanghai Haier Case[27]

On August 12, 2016, the Shanghai Price Bureau published its decision on three of Haier's subsidiaries (collectively, "Shanghai Haier") for their engagement in RPM violations. Through the investigation of Shanghai Haier, the Shanghai Price Bureau found the following behavior:

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25 The State Council Anti-Monopoly Commission will provide relevant guidelines in relation to specific procedures through which undertakings may claim exemption under Article 15 of the AML. On May 12, 2016, the NDRC published the Draft Exemption Guidelines to seek public comments.

26 See NDRC's news release, available at: http://jjs.ndrc.gov.cn/gzdt/201701/t20170111_834826.html.

27 See Shanghai Price Bureau's administrative penalty decision, available at: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/24137.htm.

(i) Issued various sales policy and notice, asking distributors not to sell below the guiding price;

(ii) Issued various managing documents, communication document, notices, etc. from time to time, asking distributors not to cross sell and deviate from the guiding price, so as to regulate the online and offline product value chain;

(iii) Signed Haier Product Distribution General Agreement and Reward Agreement with distributors, asking distributors not to deviate from guiding prices and to follow the standard retail prices for retail sales; and

(iiii) Signed a Deposit Agreement with distributors, which stipulates that once the online distributors were found violating Haier's regulation (including the RPM requirement), the deposit would be deducted.

Further, the Shanghai Price Bureau found that Shanghai Haier implemented the RPM monopoly agreement by periodically issuing a retail price restriction manual, monitoring the price deviation behavior of online and offline distributors, punishing distributors who repeatedly dishonored the guiding prices and informing distributors, orally or through WeChat, of the price adjustments. Therefore, the Shanghai Price Bureau concluded that Shanghai Haier violated Article 14(2) of the AML and Article 8(2) of the Regulation of Anti-Price Monopoly, which prohibit undertakings from restricting resale price of commodities to a third party, and fined Shanghai Haier three percent of its relevant sales generated in the previous year, totaling about RMB 12.35 million.

2. *Bright Dairy* Case[28]

On December 29, 2017, the Shanghai Price Bureau posted its administrative penalty decision on Shanghai Speed Fresh Logistics Co., Ltd. ("Speed Fresh"), a unit of Chinese dairy product supplier Bright Dairy & Food Co. Ltd., for its engagement in an RPM arrangement regarding the sale of Bright Dairy pasteurized milk products.

According to the decision, the Shanghai Price Bureau found that Article 4 of the Distribution Agreement concluded between Speed Fresh and its distributors expressly required distributors to follow the price system and promotion policy set by Speed Fresh and asked distributors not to sell to a third party at prices lower than those set by Speed Fresh. Article 6 of the agreement also asked the distributors to regulate their sale points and strictly prohibit sale points from selling at lower prices over a long period of time. Article 28 of the agreement stipulated punishment for distributors who violated the above mentioned requirements. Therefore, the Shanghai Price Bureau concluded that Speed Fresh had reached a monopoly agreement with its distributors to restrict the minimum resale price of commodities.

Further, the Shanghai Price Bureau found that Speed Fresh implemented the monopoly agreement by issuing an integrated price system (including sale price of distributors and retail price) and, from time to time, a price adjustment notice. The Shanghai Price Bureau also found that Speed Fresh, on the one hand, asked distributors to mutually monitor each other's behavior and, on the other hand, asked Speed Fresh's relevant business staff to do shop inspections and prepare reports in this regard.

In light of the above, the Shanghai Price Bureau concluded that the Speed Fresh has violated Article 14(2) of the AML and Article 8(2) of the Regulation of Anti-Price Monopoly, which prohibit undertakings from restricting resale price of commodities to a third party. As Speed Fresh had ceased the illegal conduct before initiation of the investigation, proactively took the rectification measures, actively cooperated with the investigation and voluntarily submitted evidence that the agency did not know, the Shanghai Price Bureau imposed a fine on Speed Fresh for one percent of the relevant sales revenue generated in 2015 amounting to around RMB 1.98 million.

28 See Shanghai Price Bureau's administrative penalty decision, available at: http://www.shdrc.gov.cn/fzgggz/jggl/jghzcfjds/25364.htm.

III. NDRC'S ENFORCEMENT IN IP RELATED AREA

Although the IP related area was listed as one of the NDRC's enforcement priorities, the NDRC and its local agencies did not publish an administrative penalty decision in 2016. However, according to publicly available information, the NDRC's investigation into technology firms' implementation of their IP rights never stopped. In particular, it is reported that the NDRC initiated some new investigations against technology companies last year.[29]

Furthermore, the NDRC released the Draft Antitrust Guidelines for Abuse of Intellectual Property Rights ("Draft IP Guidelines") on December 31, 2015, seeking public comments.[30] Besides the NDRC, the SAIC, MOFCOM and the State Intellectual Property Office ("SIPO") also drafted their own IP antitrust guidelines and have submitted the drafts to the Anti-monopoly Commission for integration into one comprehensive version. The final IP antitrust guidelines are expected to be issued by the Anti-monopoly Commission in 2017.

In the NDRC's Draft IP Guidelines, it proposes the following four principles in the course of analyzing IP related cases:

(i) When enforcing the AML to regulate the exercise of IP rights, the AML enforcement agencies should adopt the same regulatory standards applied to other property rights and follow the basic analytical framework of the AML, while taking into account the characteristics of IP rights;

(ii) IP rights holders shall not be directly assumed as having dominant market position due to their possession of IP rights;

(iii) When analyzing the exercise of IP rights that may eliminate or restrict competition, the AML enforcement agencies should fully consider the positive effects on competition and innovation by the exercise of IP rights on a case-by-case basis; and

(iiii) The AML enforcement agencies should adhere to fairness and transparency, and fully consider the facts, evidence and reason raised by the undertakings in relation to whether the exercise of IP rights is justifiable.

Highlights of the Draft IP Guidelines include an introduction of safe harbor mechanism, regulation on non-price related vertical restrictions that may have adverse impact on market competition, such as exclusive grant-back, non-challenge clauses, geographic restriction and customer restriction, etc., and restriction on the standard essential patent holders' implementation of injunctive relief.

The Draft IP Guidelines reflect the NDRC's experience gained through the agency's intensified enforcement activities in IP related area, for instance, the enforcement against Qualcomm and IDC. With the issuance of the IP antitrust guidelines, undertakings will be better placed to evaluate whether their exercise of IP rights may raise antitrust concerns and it is understood that the AML enforcement agencies will further intensify their enforcement in IP related areas in the future.

IV. ABUSE OF ADMINISTRATIVE POWER

In recent years, the NDRC has stepped up its enforcement against abuse of administrative power, which is a unique type of monopolistic conduct set forth in the AML. According to publicly available information, in 2014, the NDRC investigated the abuse of administrative power exerted by the Hebei Department of Transport, the Hebei Price Bureau and the Hebei Finance Bureau and suggested

29 See news report, available at: https://app.parr-global.com/intelligence/view/1485513.

30 See NDRC's release of the Draft IP Guidelines, available at: http://jjs.ndrc.gov.cn/fjgld/201512/t20151231_770233.html.

that the three departments to rectify their behavior.[31] Thereafter, in 2015, the NDRC and its local agencies also investigated at least seven cases concerning abuse of administrative power.

At the end of 2016, the NDRC announced four cases concerning abuse of administrative power, respectively:

(i) The municipal governments of 12 provinces designated certain electricity companies to construct power supply and distribution facilities and collect fees from end users. The NDRC looked into the issue and asked municipal governments to rectify the competition restricting behavior. Up to the December 2016, 10 out of 12 provinces had rectified the behavior.[32]

(ii)The Shenzhen Education Bureau set a minimum bidding price for school uniforms in 2011, where the Shenzhen Education Bureau was found to induce business operators to reach a monopoly agreement. In 2014, the Shenzhen Education Bureau used the 2011 minimum bidding price as the ceiling for the bidding and asked undertakings to quote discounts that they would like to offer. Such behavior was found to have violated the undertakings' pricing right. In addition, the Shenzhen Education Bureau set discriminatory conditions for the bidders and set discriminatory evaluation standards against non-local undertakings. The NDRC and its local agency in Guangdong province concluded that the Shenzhen Education Bureau abused its administrative power. The Shenzhen Education Bureau committed to rectify its behavior.[33]

(iii) The Shanghai Municipal Transportation Commission was found to have organized, guided, coordinated and guaranteed relevant pleasure boat operators to reach and implement monopoly agreements on fixing or changing of service prices. The Shanghai Municipal Transportation Commission committed to rectify its behavior and let the NDRC, together with relevant departments, monitor the implementation of the rectification measures.[34]

(iiii)The Beijing Municipal Commission of Housing and Urban-Rural Development was found to have issued the quality control price of concrete, which it was using as the minimum contract price. The NDRC considered that such policy in fact organized business operators to reach price monopoly agreements in violation of the AML. Therefore, the NDRC concluded that the Beijing Municipal Commission of Housing and Urban-Rural Development engaged in abuse of administrative power and the Commission committed to take rectification measures.[35]

More importantly, the introduction of the fair competition review mechanism represents a landmark progress in developing a market economy in China.[36] It brings a significant change in the government's thinking about the role of the state and its relationship with the economy. Despite China's remarkable economic development over the past decades, its transition to a modern market system is still ongoing and the legacy of a centrally planned and highly regulated system still remains in some areas of the economy. In this regard, conceived by the highest level of the Chinese government, the State Council of China issued *Opinions on Establishing the Fair Competition Review System in the Development of Market System* on June 14, 2016 ("Opinions") to first formally bring the fair competition review mechanism into being. The Opinions feature four categories of benchmarks for the substance of the fair competition review system:

31 See news report, available at: http://www.competitionlaw.cn/info/1018/22257.htm.

32 See NDRC's press release, available at: http://jjs.ndrc.gov.cn/gzdt/201612/t20161229_833273.html.

33 See NDRC's press release, available at: http://jjs.ndrc.gov.cn/gzdt/201612/t20161229_833266.html.

34 See NDRC's press release, available at: http://jjs.ndrc.gov.cn/gzdt/201612/t20161229_833265.html.

35 See NDRC's press release, available at: http://jjs.ndrc.gov.cn/gzdt/201612/t20161229_833264.html.

36 Zhang Qiong, an adviser to the State Council's Antimonopoly Commission, published an article in People's Daily, June 24, 2016, available at: http://theory.people.com.cn/n/2014/1208/c207270-26167950.html.

1. Standards of market entry and exit;
2. Standards of free flow of goods and factors;
3. Standards of affecting manufacturing and operating costs; and
4. Standards of affecting manufacturing and operating behaviors.

The major method of review contained in the Opinions is the self-review by the policy-making authorities based on the four categories of criteria. Given the inherent weakness of self-review, an independent third party review mechanism may also be introduced. Currently, the NDRC is taking the lead in drafting the implementing rules. More details as to the actual enforcement remain to be seen. The fair competition review system forms part of China's broader effort to tackle administrative monopolies and is regarded as an *ex-ante* measure to prevent administrative monopolies, alongside the AML framework, which is an *ex-post* measure to target specific administrative monopoly acts. With more resources provided to the Chinese competition authorities to fight against administrative monopolies, we are expecting a more vigorous development of China's market featured with more fair competition among market participants.

V. NDRC'S LEGISLATIVE EFFORTS

Besides the above mentioned Draft Auto Guidelines and Draft IP Guidelines, in 2016, the NDRC also issued Draft Guidelines on Commitment Made by Undertakings in Antitrust Cases ("Draft Commitment Guidelines"), Draft Guidelines on the Application of Leniency Programme to Cases Involving Horizontal Monopoly Agreements ("Draft Leniency Guidelines"), Draft Guidelines on General Conditions and Procedures on the Exemption of Monopoly Agreements ("Draft Exemption Guidelines") and Draft Guidelines on Determining Illegal Income of Undertakings' Monopolistic Behaviours and Fines ("Draft Fines Guidelines"). These guidelines mostly concern procedural rules and are aimed at providing legal certainty and transparency to the AML enforcement.

A. Draft Commitment Guidelines

The Draft Commitment Guidelines prescribe that the commitment program under Article 45 of the AML would not be applied to hard-core cartel violations, including horizontal monopoly agreements on price fixing, output restrictions and allocation of the sale or procurement market. In addition, the application to the commitment program could be brought up at any time after the initiation of the investigation and before the enforcement agency issues the advance notice of administrative penalty. The Draft Commitment Guidelines also clarify that pursuant to the commitment program, a decision on suspension or termination of an investigation shall not be interpreted as an affirmation on whether the undertaking's conduct constitutes a monopoly and the decision shall not affect other undertakings' or consumers' rights to institute a civil action with the people's court against the suspected monopoly.

B. Draft Leniency Guidelines

The most important highlight of the Draft Leniency Guidelines is that the guidelines for the first time introduce a marker system into the Chinese leniency program that a leniency applicant could submit a preliminary report to mark its ranking and supplement other materials within a prescribed time period. In addition, the Draft Leniency Guidelines also provide detailed rules regarding the scope of important evidence and the information that should be included in the report. Moreover, the Draft Leniency Guidelines stipulate that the first applicant would receive full immunity or no less than an 80 percent fine reduction; the second applicant would receive a 30 to 50 percent fine reduction; the third applicant could receive no higher than a 30 percent fine reduction. The above sliding scale could unify the different standards that the NDRC and SAIC are currently using and could provide more legal certainty to undertakings.

C. Draft Exemption Guidelines

Under the Draft Exemption Guidelines, undertakings could apply for an exemption pursuant to Article 15 of the AML after the initiation of an investigation and before the issuance of an administrative penalty decision. The AML enforcement agencies would review the undertakings' application and normally would consult with relevant undertakings and consumer representatives for their comments. Unless concerning state secrets, the AML enforcement agencies would publish the exemption decision to the public.

Except in the above scenario, the Draft Exemption Guidelines leave it to the undertakings to self-evaluate whether they could fulfill Article 15, the exemption clause, of the AML. Undertakings or industry associations may consult with the AML enforcement agencies for their opinion, but the agencies generally would refuse to provide consultation.

D. Draft Fines Guidelines

Compared with past practices, the Draft Fines Guidelines have made certain breakthroughs — first, the guidelines emphasize the significance of the confiscation of illegal gains and clearly define the scope of illegal gains; second, for the first time, the guidelines introduce a three-step fine calculation method.

Specifically, based on the logic of the AML, the Draft Fines Guidelines define the illegal gain as the additional income earned or the expense reduced resulting from an undertaking exercising monopoly agreement or abuse of market dominance in violation of the AML, during the period when the above mentioned monopoly conduct lasts.

The "three-step" fine calculation method refers to Step One — determination of sales revenue of the undertaking in the preceding year; Step Two — determination of the basic percentage for calculating the basic amount of fines by considering the nature and duration of the illegal conduct; and Step Three — making adjustments to the basic percentage determined in Step Two by considering other factors in relation to heavier, lighter or mitigated punishment and in accordance with the seriousness of the illegal conducts, thereby determining the final percentage for calculating the fines and calculating the final amount of fines to be imposed

VI. LOOKING FORWARD

We expect that the antitrust enforcement in pharmaceutical, medical device and automobile related industries will remain the NDRC's enforcement priorities in 2017. Moreover, the NDRC will further intensify its enforcement against vertical monopoly agreements in the consumable products industry, where the NDRC may likely evaluate undertakings' non-price related vertical restraints and consider them as strengthening the effect of RPM arrangement or even as a violation of Article 14(3)[37] of the AML. With respect to the IP related area, it is understood that the NDRC's enforcement in this regard will be further intensified with the issuance of the IP antitrust guidelines.

In addition, the efforts of the NDRC, together with SAIC and MOFCOM under the authorization of the Anti-Monopoly Commission, in drafting the six guidelines, will have significant impact on the landscape of antitrust enforcement in China. Once enacted, these guidelines will provide detailed rules for both the enforcement agencies and undertakings to follow, in turn increasing the transparency and consistency of enforcement activities.

37 Article 14(3) of the AML is a catch-all clause, which prohibits undertakings to engage in other vertical monopoly agreements as determined by the AML enforcement agencies.

THE *TETRA PAK* CASE: ARE LOYALTY REBATES TREATED DIFFERENTLY BY THE CHINESE ANTITRUST REGULATOR?

BY MICHAEL HAN, ANDREW SKUDDER & DAVID BOYLE[1]

  

I. INTRODUCTION

On November 16, 2016, the State Administration for Industry and Commerce of the People's Republic of China ("the SAIC") published its penalty decision against Tetra Pak, a multinational food packaging and processing company. Following a thorough investigation lasting more than four years, the SAIC imposed a fine of USD $97 million on Tetra Pak after concluding the food packaging company had abused its dominant market position in the liquid food aseptic carton packaging industry from 2009 to 2013 in breach of China's Anti-monopoly Law ("AML"). The alleged abuses involved not only the sales of packaging equipment, but also the repair services and raw materials markets. The detailed 47-page published decision highlights some interesting developments regarding the Chinese competition regulator's enforcement against abusive conduct, which in the past was considered a much more complex and less prioritized area compared to hardcore antitrust infringements such as cartels.

In particular, the SAIC's decision in relation to Tetra Pak's loyalty rebates scheme is noteworthy since it is the first time a Chinese antitrust enforcer has considered loyalty rebates offered by a dominant firm to be a violation of the AML (especially in light of the fact that loyalty rebates are not explicitly listed as an antitrust violation and, for the first time, the SAIC invoked its discretionary power under the catch-all provision of the AML to reach its own findings). Indeed the granting of such rebates by dominant firms is a hot topic for many antitrust enforcement agencies globally. In 2009, the European Commission ("Commission") imposed a record fine of EUR 1.06 billion on Intel for its conduct, including awarding rebates to computer makers. The Commission's decision was upheld by the European General Court and is currently under appeal to the European Court of Justice. The decision of the Court of Justice

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will no doubt provide welcome guidance on when such practices can fall foul of European competition law.[2]

In this article, we will focus on the SAIC's findings that Tetra Pak's loyalty rebates schemes amounted to an abuse of dominance[3] and compare and contrast this to the approach taken by the Commission in the *Intel* case.

II. TETRA PAK'S DOMINANT POSITION

In its decision, the SAIC identified three separate and independent relevant product markets; the Carton Equipment Market, the Technological Services Market and the Carton Packaging Material Market. In each of the three relevant markets, the SAIC determined that Tetra Pak held a dominant market position on the basis of four main criteria: (i) respective market shares and market structures, (ii) Tetra Pak's ability to control the market (iii) reliance of other business undertakings on Tetra Pak, and (iv) difficulty of market entry for competitors.

On the basis that Tetra Pak had a dominant position in the three relevant markets, the SAIC then investigated whether the rebates Tetra Pak offered to its customers had the effect of restricting competition and foreclosing competitors.

III. THE SAIC'S ANALYSIS OF TETRA PAK'S LOYALTY REBATES AND TARGETED DISCOUNTS

The offering of discounts or rebates to customers is normally considered part of everyday business life and generally such activities do not raise competition law concerns, rebates generally stimulate demand and benefit consumers by lowering the price. However, loyalty rebates when offered by a dominant firm can raise competition law concerns since customers purchase only (or in a large part) from the dominant undertaking, which forecloses the dominant firm's competitors.[4] In particular, retroactive rebates (i.e. those applying to all purchases once a certain purchase threshold is met) offered by a dominant undertaking are considered of greater concern from a competition law perspective since they can foreclose the market by making it less attractive for customers to switch even small amounts of orders to another supplier since they would lose the retroactive rebate if they do so.

Although loyalty rebates, or rebates in general, have not been explicitly defined or prohibited by the AML, they can potentially still fall under Article 17 of AML which covers "other abuses of dominant market positions as determined by the antitrust enforcement agencies" (the so-called "catch-all provision"). It is worth noting that prior to the Tetra Pak case, as far as we are aware, none of the Chinese antitrust agencies had applied this "catch-all provision" to sanction other antitrust infringements.

In its analysis, the SAIC considered two main elements of Tetra Pak's discounting scheme (i) retroactive loyalty rebates, and (ii) customized volume targeted rebates:

- *Retroactive loyalty rebates*: Retroactive loyalty rebates, as defined by the SAIC, refer to discounts offered retroactively on a customer's cumulative purchases when the total purchased volume reaches a certain threshold for a certain period of time. Under Tetra Pak's retroactive discount scheme, customers were offered discounts in accordance with pre-set thresholds based on the total volume of packaging material they purchased from Tetra Pak in a given year. In addition,

2 In October 2016, the Advocate General to the Court of Justice released his non-binding decision in which he recommended the General Court's decision be overturned on a number of grounds including that the General Court erred in law in its alternative assessment of capability by refusing to establish that the rebates and payments offered by Intel had in all likelihood an anti-competitive foreclosure effect.

3 The SAIC also found that Tetra Pak had abused its dominant position by tying sales and imposing exclusive supply obligations on trading partners.

4 Loyalty or fidelity rebates are discounts offered to customers which are conditional on targets being met by the customer or which induce other loyalty or fidelity type behavior towards the dominant undertaking.

Tetra Pak offered additional rebates based on a customer's purchase of two or more types of packaging material.

- *Customized volume-target rebates*: Volume target rebates amount to a straight discount on orders. Under Tetra Pak's target rebates scheme, discounts were offered to customers based on the condition that the products purchased by a specific customer in a certain period should reach or exceed a target percentage or specific fixed volume. Tetra Pak's target discounts were usually tailored by Tetra Pak according to the specific customer.

The SAIC considered that it was not only Tetra Pak's retroactive rebates which were of concern but also any form of targeted rebates offered by Tetra Pak since those also had the effect of inducing loyalty to Tetra Pak and foreclosing its competitors.

A. Key Points from the SAIC's Analysis of Tetra Pak's Rebate Schemes

The SAIC considered that Tetra Pak's retroactive rebate schemes could induce customers to stay loyal to Tetra Pak and therefore foreclose Tetra Pak's competitors. The retroactive rebates were considered to differ from other types of volume discounts based on their "retroactivity" and "cumulativeness" in volume which induced customers to purchase as many products as possible in order to reach the thresholds and enjoy higher discounts.

Regarding volume targeted rebates, the SAIC considered that the direct effect of Tetra Pak's targeted discounts was to "lock-in" a customer's demand with respect to the percentage or volume of purchases. Therefore, the targeted rebates also had the effect of inducing loyalty and foreclosing Tetra Pak's competitors. The SAIC found that both the retroactive rebates and volume targeted rebates foreclosed competitors in the market.

In finding that Tetra Pak's rebates schemes constituted a violation of the AML, the SAIC relied on the transaction statistics, sales arrangements between Tetra Pak and its customers as well as economic modelling. In particular, the SAIC focused on "contestable" and "non-constable demand" in the relevant markets.[5] The loyalty rebates offered by Tetra Pak meant that it could leverage its position in relation to non-contestable demand to the contestable demand segment of the market.

The SAIC identified specific factors in this case which meant Tetra Pak could leverage its power to the contestable demand segment. Those factors included:

- Some customers had a reliance on Tetra Pak's products, in fact some products could only be provided by Tetra Pak. The fact that some customers had a reliance on Tetra Pak's capacity in terms of some products was seen as the critical factor which enabled Tetra Pak to create non-contestable demand.

- Tetra Pak tied the sales of packaging materials with supplying equipment and technological services. This effectively locked a portion of contestable demand and converted it to non-contestable demand.

- Tetra Pak used its various discount schemes in a cumulative manner. For example, the targeted discounts were able to lock-in the purchases of a specific customer and convert this previously contestable demand into non-contestable demand.

In its analysis, the SAIC relied on sophisticated economic models and theories to show that the various rebates offered by Tetra

5 According to economic theory, for a dominant firm, its demand can be divided into contestable and non-contestable demand. The non-contestable demand can only be met by the dominant firm, whereas the contestable demand can be met by the dominant firm or its competitors.

Pak had the effect of inducing loyalty. Tetra Pak's loyalty discounts forced its competitors to offer lower discounts not only to match Tetra Pak's price but also to "compensate" for the loss of a retroactive or cumulative rebate should a customer switch from Tetra Pak. The SAIC acknowledged that lower prices are to be welcomed in the short run, however in the long run, those loyalty discounts restricted sales volume and profits of other packaging materials manufacturers, leading to inadequate capacity utilization rate, and restricted survival and development, which adversely influenced competition in the market and the interests of customers.

IV. COMPARISON WITH THE COMMISSION'S APPROACH

The SAIC's decision in relation to Tetra Pak's loyalty rebates marks the first time a Chinese antitrust agency has punished a dominant firm for such conduct. The decision brings the Chinese agencies in line with other jurisdictions, such as the EU, who have previously made some high-profile decisions in this area. While there are some similarities in the Chinese and European agencies approach to loyalty rebates, the Tetra Pak decision also highlights some differences.

A. The Legal Framework in China and the EU

The legal framework regarding an abuse of a dominant position in Europe is similar to that in China. Under Article 102 TFEU (Treaty on the Functioning of the European Union), a dominant undertaking can be found to have abused its dominant position where it offers discounts or rebates to a customer which forecloses competitors and results in consumer harm. The offering of rebates is not specifically stated as an offence under Article 102, but the European Courts have established that in certain instances it can amount to an offence. Similarly, loyalty rebates are not specifically mentioned in the AML, however the AML has a catch-all provision regarding abuse of dominance which means that conduct not expressly stated in the AML can still be considered a breach of China's antitrust law.

B. Comparison with the EU's Approach

The most recent high-profile case in Europe in relation to rebates is the Commission's investigation into Intel. The Commission found that Intel abused its dominant position in relation to "x86 Central Processing Units" ("CPUs") by (i) giving rebates to computer manufacturers on the condition that they purchase all or most of their CPU requirements from Intel and (ii) paying Original Equipment Manufacturers ("OEMs") to delay the launch of products which would compete with Intel's CPUs.

In the appeal of that decision, the General Court made a distinction between three types of rebates:

1) *quantity rebates*: the discount is linked to the volumes of sales of a customer (but not customized)

2) *exclusivity rebates*: the discount is conditional on the customer buying exclusively or almost exclusively from the dominant undertaking; and

3) *other category rebates*: a general category catching discounts which are neither quantity rebates nor exclusivity rebates.

While not all discounts offered by a dominant undertaking should be considered abusive (objective quantity discounts, for example), the rebates offered by Intel were given in return for loyalty or exclusivity and were considered *per se* illegal by the Commission. The General Court agreed with the Commission and considered exclusivity rebates to be presumptively unlawful unless objectively justified, therefore there was no need to prove actual anti-competitive effects.[6] However, in relation to the third category of rebates outlined above, the general position in the EU is that a "rule of reason" approach is required when analyzing such rebates, therefore it is necessary to assess whether the rebates have an anti-competitive effect before determining whether third category rebates are unlawful.

The two types of rebates in the *Tetra Pak* case investigated by the SAIC would likely fall under this third "other category" of rebates if the case were investigated in Europe, since Tetra Pak's rebate schemes did not require exclusivity and were not conditional on customers purchasing all or most of their requirements from Tetra Pak.[7] Such third category rebates are not considered presumptively unlawful and therefore the Commission would need to consider the anti-competitive effects of those rebates if the case were investigated in Europe. This is similar to the approach the SAIC has taken. In particular, the SAIC seems to have taken a rule of reason based approach towards Tetra Pak's loyalty rebates, relying heavily on economic analysis of the anti-competitive effects of such rebates.

While it appears that the SAIC has taken a rule of reason approach in this case, it is unclear whether Tetra Pak raised any justifications or pro-competitive arguments, or indeed whether the SAIC would consider any pro-competitive justifications since this is not discussed in the published decision. When analyzing such third category rebates, it is likely that the European Commission would consider any pro-competitive arguments put forward by the dominant undertaking and outline its assessment of those arguments in its decision. The lack of discussion on justifications in the SAIC's decision may imply that the SAIC does not consider pro-competitive justifications when investigating loyalty rebates offered by a dominant firm. Alternatively, the SAIC may have considered economic arguments put forward by Tetra Pak but redacted this information from the final decision. It is not uncommon for an authority in China to redact economic arguments raised by parties in the final published decision.

In determining whether Intel's conditional rebate schemes were illegal, the Commission used the "as efficient competitor test." This is a hypothetical test to analyze whether a competitor as efficient as the dominant undertaking, but which seeks to supply a product not as broadly as the dominant undertaking, would be foreclosed from competing.[8] The Commission found that in order to compensate an Intel customer for the loss of Intel's conditional rebates, an as efficient competitor would have had to price its CPUs below average avoidable cost, which meant even an as efficient competitor was foreclosed from competing with Intel.

The SAIC's decision does not expressly state which economic theory or test it used in its analysis. It is unclear whether the SAIC considered the "as efficient competitor" test and/or took elements from the "raising rivals cost" theory when concluding that Tetra Pak's rebates were anti-competitive. While it might be true that Tetra Pak's competitors would always have to provide similar rebates or lower prices in order to compete with Tetra Pak's rebate schemes, if Tetra Pak's competitors were not as efficient competitors as Tetra Pak, it would be difficult to argue that they were excluded from competing simply because of Tetra Pak's rebate schemes. One has to always bear in mind that the mere elimination of a particular rival does not necessarily mean there will be any harm to competition or consumers, as the elimination may be the result of genuine competition and the rival may not be an efficient competitor.

In addition, a low price can exclude competitors if they are below a certain cost benchmark. However, the SAIC's decision does not indicate what cost measurement should be used in such an analysis or how those costs should be calculated. It is unclear whether the SAIC would consider average avoidable cost as the benchmark in future cases.

6 The Advocate General's recent non-binding opinion concludes that the General Court erred in finding that 'exclusivity rebates' constitute a separate and unique category of rebates that require no consideration of all the circumstances in order to establish an abuse of dominance.

7 The published decision does not discuss whether the SAIC considered Tetra Pak's rebates effectively amounted to de facto exclusivity rebates even though Tetra Pak did not explicitly require exclusivity and the rebates were not conditional on customers purchasing all or most of their requirements from Tetra Pak.

8 In upholding the Commission's decision, the General Court held that it was unnecessary for the Commission to conduct any as efficient competitor test or carry out any cost/price analysis to reach a finding that exclusivity rebates were abusive. This point is currently under appeal to the Court of Justice.

With regard to the target rebates, according to case law and the Commission's practice, whether a target rebate is problematic will depend *inter alia* on the length of the reference period upon which the rebate is calculated and on the degree to which the criteria for granting the rebate are objective and transparent. For example, in the *Michelin I* case in the EU, in finding the rebate abusive, the General Court placed particular emphasis on the length of the reference period (one year), pointing out that customers would be unlikely to switch suppliers at any point during the year before qualifying for the rebate. The Court also relied, though to a lesser degree, on the secret manner in which the rebates were agreed, and the general lack of uniformity and transparency of the rebate scheme. In the *Tetra Pak* case, the fact that the SAIC found the customized volume-target rebates abusive seems to suggest one of the factors the SAIC might have also considered was the lack of uniformity and transparency of the rebate scheme. It is difficult to ascertain from the published decision what exact factors (e.g. the duration of the scheme) the SAIC took into consideration in reaching its conclusion.

Overall, the SAIC's general rule of reason approach to rebates is to be welcomed. While it appears evident that Tetra Pak's rebates were classified as those types of rebates which require a rule of reason analysis, it is unfortunately less clear what factors the SAIC considered in such analysis.

V. CONCLUSION

Antitrust agencies are particularly concerned with retroactive rebates offered by dominant undertakings, whereas other types of less foreclosing rebate schemes are generally considered easier to justify given their pro-competitive effects (such as stimulating demand and benefitting consumers). However, the SAIC's approach seems to focus on not only retroactive loyalty rebates but also on any form of targeted rebates offered by Tetra Pak. Further discussion, or more specific guidance, on the rebates issue would be particularly useful so that companies at or approaching dominance have a clearer understanding of how they should organize their behavior so as to remain AML compliant.

The *Tetra Pak* decision marks the first time the Chinese authorities have punished loyalty rebates and the SAIC's published decision shows an increased sophistication in its investigations. The increased use of economic models and theories outlined in the decision and the publication of a detailed 47-page decision is to be welcomed. While it would be helpful if the SAIC elaborated on some aspects of its analysis, the publication of such detailed decisions by the SAIC is a positive move which will no doubt provide useful guidance for companies and their advisors.

A REVIEW OF RECENT MERGER CONTROL ENFORCEMENT IN CHINA

BY JOHN YONG REN[1] & WESLEY ZHINING WANG[2]

I. AN OVERVIEW OF MOFCOM'S ACTIVITIES IN 2016

China's merger control regime under the Anti-Monopoly Law of the People's Republic of China ("AML"), which came into force in 2008, has continued to evolve in the past year.

A. Legislative Developments

From the legislative perspective, the Ministry of Commerce of the People's Republic of China ("MOFCOM") is modifying the draft of *Measures for Examination of the Concentrations between Undertakings* (the "Revised Measures") on January 6, 2017, seeking for opinions from companies, lawyers and scholars. The Revised Measures, to some extent, integrate the current Measures for Examination of the Concentrations between Undertakings, Measures for the Notification of the Concentrations between Undertakings, and Guiding Opinions on Declaring the Concentration of Undertakings, etc. Therefore, the content of the Revised Measures will be comprehensive. We anticipate that the Revised Measures can provide clearer guidance in relation to important but ambiguous issues in the merger control regime, such as assessment of change of control, calculation of turnover and what is "implementation of a concentration," etc.

In addition, according to the working plan of the Anti-Monopoly Commission ("AMC") under the Chinese State Council, new and integrated IP-related antitrust guidelines are being drafted by the relevant agencies. The agencies draft their own guidelines independently first, and then the AMC will integrate them into one single *IP-related Antitrust Guidelines*. The drafting agencies include: the National Development and Reform Commission ("NDRC"), the State Administration for Industry and Commerce ("SAIC"), the State Intellectual Property Office ("SIPO") and MOFCOM. MOFCOM drafted the merger review chapter of the integrated *IP-related Antitrust Guidelines*. It

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is believed MOFCOM has finished its chapter and submitted it to the AMC for integration.

Both the Revised Measures and the integrated *IP-related Antitrust Guidelines* are expected to come into force in 2017.

Moreover, according to the "deepen reform" working plan of the State Council, MOFCOM will coordinate with other Chinese anti-monopoly enforcement agencies (i.e. the NDRC and the SAIC) to promote the *Opinions of the State Council on Establishing the Fair Competition Review System in the Development of Market System*.[3] According to the Opinion, MOFCOM's future rules and guidelines are subject to the Opinion's fair competition review.

B. MOFCOM's Enforcement in Practice

In practice, MOFCOM had a record year again in 2016. According to the MOFCOM spokesman, in 2016, MOFCOM received 378 merger notifications, conducted reviews of 360 cases, and concluded 395 cases. In 2016, 324 cases, or 82 percent of all cases, were concluded during the 30-calendar day Phase I period, an increase of 8 percent from that of 2015.[4] In addition, cases that were processed under the simplified procedure accounted for 76 percent of all filings. Approximately 98.6 percent of all simplified procedure cases that were filed were concluded during the Phase I stage.

In 2016, MOFCOM publishes two approvals with remedies: *Anheuser-Busch InBev/SAB Miller*[5] and *Abbott/LightLab*.[6] The two cases are both horizontal mergers. For *Anheuser-Busch InBev/SAB Miller*, the relevant product was beer and the combined market share exceeded 40 percent. For *Abbott/LightLab*, the relevant product was small vascular closure device and the combined market share exceeded 95 percent. Not surprisingly, the remedies adopted in both the two concentrations are structural, i.e. divesture.

It is also notable that one notification was withdrawn from MOFCOM: *Lam Research/ KLA-Tencor*. On October 5, 2016, Lam Research announced that it gave up the acquisition of KLA-Tencor. MOFCOM formally initiated the review process on April 21, 2016. In 2015, Lam and KLA-Tencor were the second largest and the fifth largest semiconductor manufacturers in the world. After the presumptive merger, the new enterprise would be the largest in the world. During the review process, MOFCOM had close cooperation with the anti-monopoly law enforcement agency of the United States and South Korea, and exchanged views on issues such as the review progress and fair competition, etc.

In addition to the finished high profile cases, MOFCOM is reviewing a few high profile concentrations which are simultaneously reviewed by other major antitrust jurisdictions, such as *Dow/DuPont, Bayer/Monsanto* and *ChemChina /Syngenta*. In such high profile cases, MOFCOM tends to ask for waivers more often than before, which indicates that the communications and cooperation between MOFCOM and antitrust authorities in other jurisdictions are more and more frequent. According to MOFCOM's official press release on January 11, 2017,[7] in 2016, MOFCOM cooperated with the antitrust enforcement authorities in the U.S. and EU in more than 10 merger filings. Such cooperation is beneficial to the legal certainty of enforcement and consistency within different jurisdictions.

Last but not least; MOFCOM published four decisions regarding the punishment of failure to notify since 2016. For compar-

3 Order of the State Council [2016] No. 34, published on June 1, 2016, and are promulgated for implementation as of June 1, 2016.

4 See, Qin Zhengyang, "MOFCOM: 2016 Antitrust Review Achieved Remarkable Results", [秦正阳："商务部：2016反垄断审查取得显著成效"] *China Review Network*, January 5, 2017, available at: http://hk.crntt.com/doc/1045/3/2/3/104532391.html?coluid=45&kindid=0&docid=104532391&mdate=0106105655.

5 See, the official website of MOFCOM: http://fldj.mofcom.gov.cn/article/ztxx/201607/20160701369044.shtml.

6 See, the official website of MOFCOM: http://fldj.mofcom.gov.cn/article/ztxx/201612/20161202440204.shtml.

7 See, "MOFCOM's Annual Review in 2016, Volume 20", available (in Chinese) at: http://www.mofcom.gov.cn/article/ae/ai/201701/20170102499312.shtml.

ison, in 2015, MOFCOM also published four punishment decisions for failure to notify. In 2014, MOFCOM published three. In the latest published punishment decision, MOFCOM held that Canon and Toshiba Medical violated the AML because they failed to notify Canon's acquisition of Toshiba Medical before implementation. Therefore, MOFCOM imposed a fine of RMB 300,000 (about USD $43,500) upon Canon.[8]

II. SOME NEW PRACTICE DEVELOPMENTS IN 2016

A. Continue to Strengthen the Investigation towards Failure to Notify

It is notable that in practice, MOFCOM continues to strengthen its investigation towards the failure to notify concentration before implementation.

In relation to the punishment method, fines are the main punishment method. The amount is around RMB 300,000-400,000 (about USD $43,500-$58,000). Although the monetary punishment seems light, MOFCOM's publication of its punishment decision will have significant negative impact on a company's reputation, especially when the company is a reputable publicly listed company. In addition, MOFCOM will ask the companies concerned to stop the concentration immediately and file the notification from the very beginning, which can be very time consuming. Therefore, for a concentration which reaches the turnover thresholds, it is highly inadvisable for the notifying party(s) to implement the concentration before obtaining MOFCOM's approval. Moreover, according to MOFCOM Anti-Monopoly Bureau's Deputy Direct General, Mr. Han Chunlin, "MOFCOM will further strengthen the investigation and punishment towards the activity of illegal failure to notify."[9]

B. Stricter Formality Requirement of the Notification Form

According to MOFCOM's recent practice, formality requirement tends to be stricter than before. It seems MOFCOM is paying more and more attention to quantity analysis and details rather than just general and brief descriptions. This tendency is evident typically from the following two aspects.

1. Defining Relevant Product Market

It seems that MOFCOM recently requires the notifying party(s) to provide more comprehensive and detailed descriptions in defining the relevant product market than before.

According to Article 4 of the *Guidelines of the State Council's Anti-monopoly Commission Concerning the Definition of Relevant Markets* ("Guidelines of Relevant Markets"),[10] the scope of the relevant market mainly depends on the degree to which the commodities (territories) can be substituted for one another. The substitutability includes demand side and supply side.

According to MOFCOM's practice, it normally asks the notifying party(s) to provide: (i) an introduction of the relevant product; (ii) an analysis regarding whether the relevant product constitutes an independent relevant market; and (iii) an analysis regarding whether the relevant product market can be further segmented.

8 See, MOFCOM's official website: http://fldj.mofcom.gov.cn/article/ztxx/201701/20170102495433.shtml.

9 See, Wang Xiao: "Chinese Anti-Monopoly Enforcement is Fully Accelerating", [王晓：我国反垄断执法全面提速], *www.comnews.cn*, January 23, 2017, available at: http://epaper.comnews.cn/news-1157550.html.

10 *The Guidelines of Relevant Markets* was enacted by Anti-monopoly Commission under the State Council, and came into force on May 24, 2009.

First, for an introduction of the relevant product, MOFCOM requires the notifying party(s) to provide a comprehensive, detailed and thorough introduction of the relevant products.

Second, for the analysis regarding whether the relevant product constitutes an independent relevant market, although in the absence of explicit rules, according to MOFCOM's practice, it requires the notifying party(s) to provide analysis on demand and supply substitutability, including the detailed analysis from all of the following aspects:

- Market price;
- Switch cost;
- Production/ Manufacturing process;
- Functions of the product; and
- Industry opinions.

Third, in order to assess whether the relevant market needs to be further segmented, MOFCOM requires the notifying party(s) to provide detailed analysis from all of the following aspects:

- Demand substitutability of the segmented products;
- Supply substitutability analysis (including the production switch) of the segmented products;
- Market price of the segmented products;
- Production/manufacturing process of the segmented products;
- Functions of the segmented products; and
- Industry opinions.

In addition, MOFCOM, more and more, requires notifying party(s) to add quantitative analysis and supportive data in relation to demand and supply substitutability analysis, the existence of neighboring market, the possibility of conducting tying/bundling, etc.

2. Defining Relevant Geographic Market

In relation to defining geographic market, recently, MOFCOM's formality requirement in this section can be very strict. MOFCOM strictly requires the notifying party(s) to provide the following information of the relevant products:

- The relevant product's import and export volume and percentage in the last year;
- HS code;
- Tariff rate (both MFN and GEN);
- Transportation cost ratio of the sales price of the product, etc.

The above remarks need to be supported by quantitative analysis and supportive data.

In practice, MOFCOM values the above factors carefully when analyzing the geographic scope. For example, if the export percentage of a product is high, international transaction cost and the tariff rate are low; MOFCOM may define the relevant geographic market as worldwide. On the other hand, if the import percentage of a product is low while the international transaction cost and the tariff rate are high, MOFCOM may regard the relevant geographic market as national. Nevertheless, it is notable that for some special products (such as drugs and pesticides), the import volume and percentage are high and the transportation cost is low. However, the geographic market of such products could be regarded as national because of the strict regulatory framework in China.

3. Possible Consequence of Failing to Provide the Information Required

If the notifying party(s) fails to satisfy the above formality requirements, most likely, MOFCOM will ask the party(s) to provide the above information in the responses to supplemental questions. However, MOFCOM might ask the notifying party(s) to refile the case if it believes absence of the above information has substantially affected the quality of the notification (e.g. making the notification misleading or incomplete).

C. Applying Simplified Procedure with More Caution: Revocation of Simplified Notification

Article 2 of the *Interim Provisions for the Standards of the Simplified Procedure of the Concentrations between Undertakings* ("Simplified Notification Standard Provisions")[11] provides the criteria of applying simplified notification procedure.[12]

If a concentration is notified as a simplified case to MOFCOM, it should satisfy the above criteria. Otherwise, MOFCOM has the discretion to revoke the simplified notification. In 2016, it seems MOFCOM adopted a more cautious way to assess whether a notification qualifies the criteria in Article 2 of the Simplified notification Standard Provisions. Typically there are three possibilities:

1. Revocation Because of Failure to Define the Neighboring Market

MOFCOM may ask the party(s) to revoke the simplified notification if either the first three criteria in Article 2 of the Simplified Notification Standard Provisions are not satisfied.

One of the most common situations of revocation faced by the notifying parties may be the failure to define neighboring market and if the market share in this market exceed 25 percent. Under the Chinese merger regime, there are no explicit rules about how to define the neighboring market. According to Footnote 37 of the standard normal notification form, neighboring market means a series of products which has complementary nature or the same group of customers and the same end use. MOFCOM mainly relies on two factors to assess the existence of neighboring market: (i) whether the products of the parties can be sold to the same group of customers; and (ii) whether the products of the parties are for the same end use. If the answers to the two questions are yes, MOFCOM normally will regard such products as "neighboring products" and thus define the neighboring market. Please note, MOFCOM

11 Announcement of the Ministry of Commerce [2014] No.12, on March 11, 2014.

12 Article 2 provides: A concentration of undertakings that falls under any of the following circumstances may be treated as a simplified case:
(1) all the undertakings participating in concentration hold less than 15 percent of market share in total in the same relevant market;
(2) both upstream and downstream undertakings participating in concentration hold less than 25 percent of market share in the upstream and down stream market;
(3) the undertakings participating in concentration who neither in the same relevant market nor have any upstream and downstream relationship hold less than 25 percent of market share in their respective markets that relate to their transaction;
(4) although joint ventures are established outside China by the undertakings participating in concentration, the joint ventures ("JV") do not engage in any economic activities in China;
(5) although the undertaking participating in concentration acquire the equities or assets of overseas enterprises, the overseas enterprises do not engage in any economic activities in China; or
(6) the joint venture jointly controlled by more than two operators is controlled through concentration by one or more of them.

seldom leaves the market definition open.

For a simplified notification, if the notifying party fails to identify the products of the parties which can be sold to the same group of customers and be used for the same end use, plus either of the relevant products' market shares exceeds 25 percent, MOFCOM may ask the notifying party to revoke the simplified notification because the concentration fails to meet the requirement of Article 2 (3) of the Simplified Notification Standard Provisions.

2. Revocation Because the Segmented Market Share Exceeds the Thresholds

Another common reason for revocation is that the segmented market share exceeds the thresholds. In 2016, MOFCOM usually asks the notifying party(s) whether the relevant product market provided can be further segmented. Especially for some simplified cases, even if MOFCOM agrees that there is no need to further segment the relevant product market defined in the notification form, it may still ask for the market share data of the segmented markets. If MOFCOM finds that the market share of the segmented market(s) exceeds the thresholds provided by Article 2(1), (2) or (3) of the Simplified Notification Standard Provisions, the simplified notification may be revoked by MOFCOM.

3. Revocation Because of the "Misunderstanding" of Article 2(4) and (5)

Article 2(4) of the Simplified Notification Guidelines describes a situation where a JV is established outside China and has no economic activities in China. According to the Simplified Notification Guidelines, in this context, simplified procedure should be applicable.

However, in practice, it is not clear, according to the Simplified Notification Guidelines, about how to ensure that the JV "has no economic activities in China." Even, based on the agreement, the parent companies in the transaction will establish a JV having no connection with China, MOFCOM may query that how to ensure the new JV will not have any economic activities in China in the future. In particular, if the geographic market of the relevant product is defined as worldwide, it could be very hard to convince MOFCOM that the JV "has no economic activity in China" in future since the sale of products may have impact on the Chinese market. In this context, MOFCOM may hold that Article 2(4) is not applicable and therefore revoke this simplified notification.

Article 2(5) describes a situation where an undertaking purchases the equities or assets of overseas enterprises, the overseas enterprises do not engage in any economic activities in China. The issue is similar. It could be hard to convince MOFCOM that, even the overseas enterprise (target) is not active in China when it is acquired, the target will not engage in any economic activities in China in the future.

Therefore, as MOFCOM's attitude towards Article 2(4) and (5) tends to be conservative, if one wants to apply simplified procedure based on Article 2(4) and (5), s/he may need to be prudent.

III. FUTURE TRENDS

From the legislative perspective, it can be expected that with the issuance of the Revised Measures as well as other guidelines, the legal certainty of MOFCOM's merger review enforcement will be further increased.

From MOFCOM's practice in merger control, based on the above observations, first of all, MOFCOM continued to publish a series of punishment decisions regarding failure to notify in 2016. In the future, MOFCOM may further strengthen the enforcement to illegal failure to notify. The punishment for failure to notify may be more severe.

Second, it seems that MOFCOM's requirements regarding the quality and formality of the notification documents tend to be stricter recently. If the notifying party(s) fails to satisfy the requirements, MOFCOM may ask the notifying party(s) either (i) to provide the information required in supplemental questions; or (ii) to withdraw. In the foreseeable future, this trend may continue.

Third, for simplified cases, it seems MOFCOM tends to be cautious about applying the simplified procedure to prevent the parties' abuse. This tendency may also continue in the foreseeable future.

IV. CONCLUSION

Given the above, for practitioners, from the legislative perspective, legal certainty of MOFCOM's enforcement will be further increased. In particular, when MOFCOM deals with high profile cases, close and frequent communication and cooperation between MOFCOM and other major jurisdictions will benefit the consistency of the outcome of a notification in different jurisdictions.

According to our observation of MOFCOM's recent practice and anticipation of MOFCOM's future enforcement trend, it is important to follow its rules. In particular:

First, for a concentration which reaches the turnover thresholds, it is advisable to notify the concentration and obtain MOFCOM's approval before implementing the concentration. Not only because MOFCOM maintains the practice of publishing its punishment decision regarding failure to notify, but also, MOFCOM's Deputy Direct General clearly emphasized that MOFCOM will further strengthen the investigation towards failure to notify in the future.

Second, it is advisable to follow MOFCOM's formality requirement and improve the quality of the notification form, which seems to be stricter than before.

Third, for one who wants to apply for simplified procedure, s/he should pay attention to the following three issues: (i) whether there exists neighboring market(s) in this transaction and, if yes, whether the market share of the relevant product in the neighboring market(s) exceeds 25 percent; (ii) whether the relevant product market defined in the notification form can be further segmented and, if yes, whether the market share of the relevant product in the segmented market still qualifies the criteria provided by Article 2(1), (2) and (3) of the Simplified Notification Guidelines; and (iii) whether Article 2(4) and (5) will be accepted by MOFCOM if there is no solid evidence showing that the new JV or the overseas target will not have any economic activities in China in the future.

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