

ANTITRUST ENFORCEMENT OF THE NDRC AND SAIC: RETROSPECT AND PROSPECT



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I. OVERVIEW OF ANTITRUST ENFORCEMENT IN 2017

Administrative antitrust enforcement in China continuously intensified in 2017. The most distinctive feature was hitting a record high for investigations involving abuse of administrative power. It is expected that in 2018, enforcement authorities will continue to target key sectors that impact the people's daily lives and may prioritize enforcement on certain typical patterns of monopolistic activities.

A. Highlights in Antitrust Enforcement of the NDRC in 2017

In 2017, the National Development and Reform Commission ("NDRC") investigated and closed over 60 cases on abuse of administrative power to restrict or eliminate competition.² This is a record high for antitrust enforcement and the industries involved are closely related to the people's livelihood such as pharmaceuticals, engineering, construction, transportation, insurance, tourism, public utilities, etc. The cases took place in more than 20 provinces, which on the one hand shows the prevalence of administrative monopoly across the country and on the other hand indicates the remarkably increased enforcement towards administrative agencies and organizations.

With regard to the types of conducts, a vast majority of the cases relate to the abuse of administrative powers to restrict the sale, purchase or use of commodities provided by designated undertakings. In accordance with Article 51 of the Anti-Monopoly Law ("AML"), all administrative agencies and organizations being investigated have shown a cooperative attitude and taken the initiative to make rectifications in a timely manner with the aim of protecting fair competition and promoting an orderly market system.

In addition, the NDRC investigated and closed 16 price-related monopoly cases in 2017 and the total financial sanctions amounted to RMB 560 million (U.S. \$86 million). The 16 cases involved industries such as electricity, Polyvinyl chloride ("PVC"), papermaking, cement, ports, telecommunications and the auto sector. Considering the background that China is implementing supply-side structural reforms in order to shutter over-capacity and enhance innovation, the NDRC is keen to target companies that respond by price-fixing.

Among the price-related monopoly cases last year, a representative one is the *PVC* case, in which the NDRC official handling the case obtained key evidence of the producers' price collusion in their group chats on the mobile texting app WeChat. The WeChat interactions led to 13 price monopoly agreements, resulting in a surge of product prices in the market and severely increasing the burden on downstream players. In the penalty decision, the NDRC imposed an aggregate fine of RMB 457 million (U.S. \$69 million) on 18 PVC producers in October 2017, equivalent to 1-2 percent of the relevant sales of the cartel participants in 2016.

Another representative case is the *Paper-Making* case, in which the industry association was found to have breached Article 16 of the AML and was ordered to de-register. It was found that the industry association, i.e. Fuyang District Paper Manufacturers' Association, organized a meeting between the 17 paper manufacturers to reach an agreement on collectively raising prices of whiteboard sheet rolls and all of the participants implemented the agreement. In its penalty decision, Zhejiang Provincial Price Bureau imposed an aggregate fine of RMB 7.78 million (U.S. \$1.14 million) on 17 local paper manufacturers in July 2017, equivalent to one percent of the relevant sales of the cartel participants in 2016.

B. Highlights in Antitrust Enforcement of the SAIC in 2017

In 2017, the State Administration for Industry and Commerce ("SAIC") opened 18 antitrust investigations, while closing 5 cases.³ Among the 18 investigations, 10 concerned cartels and 8 concerned abuse of market dominance. In addition, the state and provincial administrations for industry and commerce ("AICs") investigated 13 cases involving administrative monopoly last year. While the SAIC continued to prioritize industries that are closely related to the people's livelihood such as public utilities, fireworks, medicine, liquefied petroleum gas, natural gas, insurance, telecommunications, etc., the ratio of punishment seemed to significantly climb up in 2017 with some reaching 5 percent or even 7 percent of the relevant sales in the preceding year.

² As introduced by Zhang Handong, Director-General of the Price Supervision and Anti-Monopoly Bureau of the NDRC, on the China Competition Policy and Law Conference 2017/2018.

³ As introduced by Wanli Lu, Deputy Director-General of the Anti-monopoly and Anti-Unfair Competition Enforcement Bureau of the SAIC, on the China Competition Policy and Law Conference 2017/2018.

Since the implementation of the AML in 2008, the AICs have launched 91 antitrust investigations of which 45 related to cartels and 46 related to abuse of market dominance, involving sectors such as medicine, tobacco, radio and television broadcasting, insurance, gasoline, natural gas, power supply, computer software, furniture, household appliances and food packaging. According to decisions published on the SAIC's website, the AICs that have been playing an active role in antitrust enforcement include those in Jiangsu, Henan, Hunan, Zhejiang, Sichuan, Inner Mongolia and Chongqing.

II. LEGISLATIVE DEVELOPMENTS AND IMPLICATIONS

The six antitrust guidelines for the automobile industry, intellectual property, leniency program, commitments, exemptions, illegal gains and fine calculation were not formally published in 2017. Some argue that the guidelines for illegal gains and fine calculation were stymied by internal debates and may not be issued ultimately. In addition, the NDRC is active in publishing price behavior guidance for particular industries and for industry associations. Moreover, the Implementation Rules for the Fair Competition Review System were finalized and published in October 2017.

A. Antitrust Guidelines

From the end of 2015 to June 2016, the antitrust authorities successively published the drafts of the antitrust guidelines, seeking public comments. In August 2017, the antitrust guidelines for the automobile industry and IPRs were submitted to the Anti-Monopoly Commission under the State Council. In November 2017, Director-General Handong Zhang revealed that the NDRC had finalized the antitrust guidelines for the automobile industry and will publish it soon. In the drafting and comment process of the above guidelines, the antitrust authorities have sought various opinions and made numerous amendments. This reflects the sensitivity and importance of the issues covered in the guidance as well as the prudent attitude of the antitrust authorities.

In addition to the automobile industry, the NDRC pays extra attention to the pharmaceuticals industry. In November 2017, the NDRC published the Price Behavior Guidelines on Operators of Active Pharmaceutical Ingredients and Drugs Prone to Shortages, which prohibit operators of active pharmaceutical ingredients ("APIs") and drugs prone to shortages from reaching monopolistic agreements with other parties to maintain resale prices, including entering into agreements for fixing prices at which they resell drugs and APIs to third parties, and other agreements identified by the antitrust authorities.

Meanwhile, the influence and participation of industry associations in anticompetitive conduct regulated by the AML, as well as a proliferation of their law-breaching activities, has been increasingly highlighted. It is notable that multiple decisions issued by different antitrust authorities involved industry associations, such as penalties against Shanghai Gold & Jewelry Trade Association, Zhejiang Insurance Association, Shanxi Electric Power Association, Lianyungang Building Materials and Construction Machinery Industry Association, Liaoning Building Materials Industry Association, a number of insurance associations in Hunan, Xishuangbanna Tourism Association, Shangyu Concrete Industry Association, etc. In this context, the NDRC published the Industry Association Price Behavior Guidance in July 2017, which is aimed at guiding industry associations to promote healthy development of industries, and safeguard market price order and fair competition. It is stipulated that industry associations that severely breach price and antitrust laws and regulations run the risk of being blacklisted by price supervision departments and can face joint penalties imposed by multiple relevant authorities.

Apart from the above, since November 2017, the NDRC has begun drafting regulations on pricing of standard essential patent ("SEP") licenses and antitrust guidelines on price-related vertical agreements or conduct concerning resale price maintenance. The SAIC also plans to draft similar guidelines on non-price vertical restraints.

With the upcoming introduction and formulation of these guidelines in the near future, it is expected that the antitrust authorities will take a more in-depth look at specific significant industrial sectors and refine relevant regulations that are applicable to various industries respectively, which can serve as important guides for a wider range of industries. Furthermore, following the upcoming guidelines, the antitrust authorities will implement more transparent procedures in different stages of antitrust enforcement. From the perspective of enterprises, these guidelines will provide more legal certainty and transparency for enterprises to rely on, and will also raise awareness of compliance and require enterprises to establish and improve their compliance system.

B. Fair Competition Review System

Over the past decades, China has made extraordinary economic progress in a relatively short period of time. Notwithstanding this development, China's transition to a modern market system is still on-going and the legacy of a centrally planned and highly administered and regulated system still remains in some areas of the economy. For example, certain current administrative and economic management systems give central and local government bodies extensive powers to intervene and participate in markets relevant to the industries and geographical areas in their jurisdictions.

Against the above background, the Opinions on Establishment of Fair Competition Review System during the Development of Market System issued by the State Council ("State Council's Opinions") on June 1, 2016 confirm the decisive role of the market in the allocation of resources and set out the overall requirement and fundamental principles of establishing the fair competition review system. This review system aims to prevent the government from excessively or inappropriately impairing market competition, and to successively eliminate and abolish provisions and practices that may impede the unified domestic market and the fair competition, such as local protectionism, regional foreclosure, industrial barriers, enterprise monopoly, illegal favorable policies or impairment of market players' interests.

Following the State Council's Opinions, the NDRC, the Ministry of Finance, the Ministry of Commerce, the SAIC and the Legislative Affairs Office of the State Council have jointly published the Detailed Rules for the Implementation of the Fair Competition Review System which provides details on review mechanisms and procedures, review standards, exceptions, social supervision and accountability system. The NDRC, the Ministry of Finance and the Ministry of Commerce have also jointly issued a 2017-2018 work plan on removing existing anticompetitive policy measures, according to which government agencies at different levels have been asked to scrutinize regulations, prescriptive documents, and other policy measures that are currently in force, and to remove any content or practice that may possibly lead to local protectionism, designating transaction parties or creating barriers to market entry.

III. ENFORCEMENT TRENDS AND OUR ADVICE

A. Targeted Industries and a "New" Competition Enforcement Landscape

In 2018, certain key industries and areas will continue to be the focus of the NDRC and SAIC's antitrust enforcement. The NDRC will target key sectors that impact the people's daily lives, such as natural gas, pharmaceuticals, intellectual property, mobile phone chip manufacturing, automobile manufacturing,⁴ tobacco and alcoholic beverages,⁵ and may plan to place more emphasis on enforcement against industry associations that organize their members to participate in anticompetitive conduct. The SAIC will pay particular attention to the industries related to the national economy and the people's livelihood, including pharmaceuticals, public utilities, and so forth.

Meanwhile, it should be noted that the State aims to boost enforcement against local governments with the Implementation Rules for the Fair Competition Review System having been finalized and published in 2017, and that government agencies at each level are mobilized to implement the new system by conducting self-review in the policy-making process. In January 2018, the NDRC established a new division called the Fair Competition Review Division in order to restrict local governments from intervening in pricing during their formulation of policies, such as through discriminatory terms for market entry or designating preferred suppliers of goods and services. It is likely that the State's fight against administrative monopoly through the AML, which is an *ex-post* control, will be stiffened with the fair competition review system, as the *ex-ante* control mechanism, being brought into the competition enforcement landscape.

B. Specific Problematic Behavior and Emerging Issues

Considering the enforcement characteristics in 2017 and the legislation development in 2018, we are of the view that the following specific behaviors shall be carefully reviewed:

⁴ Available at: http://news.china.com.cn/2018-01/30/content_50349566.htm.

⁵ Available at: http://travel.china.com.cn/txt/2018-02/13/content_50509796.htm, see also: http://finance.ifeng.com/a/20180207/15975186_0.shtml.

1. Information Exchange Between Competitors

From the perspective of horizontal monopoly agreements, apart from monopoly agreement being explicitly prohibited by Article 13 of the AML, information exchange between competitors should also be closely monitored.

Based on the AML, information exchange itself does not constitute an illegal conduct. However, if companies, on the basis of information exchange, engaged in coordinated conduct such as price fixing, output or sales restriction or market division, such conduct may constitute monopoly agreement prohibited by Article 13 of the AML. Therefore, if competitors exchange information related to pricing, output restriction or customer division etc., which can be used to facilitate the constitution of monopoly agreements prohibited by Article 13 of the AML, such conduct may attract attention from the antitrust authorities.

On July 20, 2017, the NDRC published the Industry Association Price Behavior Guidance, which is the first antitrust regulation that explicitly elaborates anticompetitive effects and legal risks of information exchange and again rings the alarm for business operators. The Guidance indicates the antitrust authorities' attitude towards information exchange to some extent and it is predictable that the antitrust authorities will continue to pay attention to this area in their enforcement practices. According to the Guidance, it expressly lists conduct types that bear different levels of legal risks and articles related to information exchange are mainly stipulated in Articles 7-9.

More particularly, industry associations may assist companies to share price-related information and potentially reach monopoly agreements mainly through the following three types of conduct: (1) organize members to exchange price-related information and inform other members or players in the industry of such information; (2) release indicative price information such as guide price, bench mark price, reference price, recommended price, etc.; and (3) impose restrictions on cost components and profit margins by enforcing a specific calculation formula. The legal risks of the above conduct are all extremely high as stated in the Guidance.

The Guidance also lists elements to be considered when assessing anticompetitive effects of information exchange, including characteristics of the market and the nature of the information exchanged. It is noteworthy that Article 8 of the Guidance mentions that compared with price information that is historical, general and publicly available, current or future price information of a specific company or product which is not publicly available may be more likely to result in price monopoly agreements among companies. With regard to market characteristics, market concentration, links between upstream and downstream market, and management power that can be exerted by industry associations over their members should be taken into account.

In view of the above, we would suggest:

- Avoiding exchanging information about price, output, customers and sales territories in daily operations including attending industrial seminars;
- Duly and explicitly expressing objection in the case that other attendees raise sensitive issues as mentioned above during industrial seminars; and
- Immediately leaving the seminar and raising clear objection, and leaving with a record taken in the case where the seminar continues to discuss sensitive issues.

2. Price-Related Vertical Agreement and Non-Price Vertical Restraints

Companies should be cautious of the NDRC's steadfast position on vertical monopoly agreement and this may be reflected in the antitrust guidelines on price-related vertical agreements that the NDRC is contemplating drafting.

In addition to such vertical price maintenance explicitly prohibited by Article 14 of the AML, attention should also be attached to non-price vertical restraints. No clear provision is provided by the AML regarding non-price vertical restraints that may constitute monopoly agreements. However, considering that both the antitrust guidelines for the automobile industry and the antitrust guidelines for intellectual property, which are about to be published, provide provisions related to non-price vertical restraints, companies should attach sufficient importance to compliance issues related to non-price vertical restraints in their operations in the future.

Non-price vertical restraints mainly entail territorial restraints and restraints on sales customers. The latest draft of the antitrust guidelines for the automobile industry could serve as an important reference in this regard. It stipulates that exemptions under Article 15 of the AML may directly apply when business operators that do not have substantial market power impose such restraints as long as the restrictions promote efficiency and are justified. Such restraints include: (1) requiring authorized dealers to only carry out business activities within their own business localities, without any restrictions on those dealers' passive sales to clients or cross-supply between different dealers; (2) restricting an authorized dealer from active sales in relation to areas or customers exclusively allocated to another authorized dealer; (3) restricting a wholesaler from directly selling to an end customer; and (4) auto suppliers restricting a dealer from selling components of an auto product to a type of customer so as to pre-empt the customer from purchasing the components to manufacture auto products similar to the supplier's.

However, the automobile guidelines also specify the following conduct in connection with territorial and customer restraints which could generally lead to serious competition restrictions by causing high prices and limiting customers' choices and therefore cannot be presumably exempted under Article 15 of the AML: (1) restricting an authorized dealer from passive sales; (2) restricting different authorized dealers from cross-supply; and (3) restricting an authorized dealer or an authorized repair service provider from selling parts to end customers needed for repairing their vehicles.

It is worth noting that in the NDRC's penalty decision against Medtronic's pricing monopoly there is a clear reference to the fact that vertical restraints on territories and sales customers, as well as restrictions on sales of competing products, would reinforce the implementing effect of the price-related vertical monopoly agreements. With the relevant guidance coming into force in the near future, it is expected that non-price-related restrictions may become the focus of the antitrust authorities, and that in the absence of price-related vertical restraints, non-price-related vertical restraints alone may attract the attention of the antitrust authorities as well.

In view of the above, we would suggest:

- During the daily operations, cautiously imposing restrictions regarding channel regulation, territorial and customer restriction;
- Before adopting non-price vertical restraints, analyzing the company's market power and the potential effect on competition that may be caused by the restriction; and
- Keeping an eye on the authorities' enforcement and legislation activities regarding non-price vertical restraints and making adjustment on distribution agreements accordingly.

3. Abuse of Dominant Market Position

With respect to abuse of dominant market position, apart from a single dominant player conducting typical abusive acts and other abusive acts that may fall within the "the other abusive acts" set out in Article 17(7) of the AML, attention should also be attached to multiple players' abuse of collective dominance.

In August 2017, the NDRC issued its official decision against Zhejiang Second Pharma and Tianjin Handewei Pharmaceutical for abuse of dominance in relation to isoniazid APIs and imposed RMB 443,900 (U.S. \$66,002) in cumulative fines on the two companies. In the decision, the NDRC concluded that Zhejiang Second Pharma and Tianjin Handewei Pharmaceutical collectively held a dominant position in the relevant market of Chinese domestic medical-use isoniazid APIs. Their combined share exceeded two-thirds in 2013 and they had a strong control over the market with downstream manufacturers heavily relying on them. By ceasing the supply of APIs to their original customers, the two companies forced some preparation manufacturers to discontinue or suspend production, which caused significant losses. And the relevant market was deemed to have high entry barriers. Therefore, the NDRC determined that the two companies held a dominant position in the medical-use isoniazid APIs market and the abusive acts involved mainly included selling APIs at excessive prices and refusing without any justification to supply isoniazid APIs to downstream manufacturers.

As for companies that may be deemed as dominant in relevant markets, we suggest:

- Monitoring market shares of the company itself and its competitors;
- Monitoring complaints of upstream or downstream players;
- Conducting a comprehensive assessment of potential impacts upon competition of the company's price-related or non-price-related arrangements with upstream and downstream players;
- Conducting the compliance assessment based on practical effects rather than forms with regard to the specific restraints provisions; and
- Reviewing underlying justifiable reasons of the company's commercial policies.

4. Related Behaviors in Emerging Industries

Apart from certain conduct stated above which may become the enforcement focus in the antitrust area in 2018, in the future, the antitrust authorities may also attach significant importance to the internet industry and "Big Data."

As stated above, restriction on territories or channels has become a primary focus of enforcement authorities. As one of the distribution channels, internet sales are cross-regional and are often restrained by suppliers in practice due to its characteristics. With relevant antitrust guidelines to be formally introduced in the near future, the legal nature of restrictions on territories or channels will be clarified and the compliance of internet sales restrictions needs to be further studied.

In addition, "Big Data" has become a continuous hot topic in global antitrust circles in recent years. With the rapid rise of internet enterprises, data has become an essential factor affecting competition. It has been widely discussed whether data could be the entry barrier for some markets and could influence the determination of players' market power. Meanwhile, as "Big Data" often relates to personal privacy, it is a more sensitive issue than normal antitrust issues.

Considering the complex nature and dynamic transformation of the internet market, it may raise new challenges for the antitrust authorities in determining anticompetitive conduct. More importantly, in these rapidly growing industries, the balance between efficiency improvements and the maintenance of competitive order shall be thoroughly analyzed and subtly handled. As explained by Yang Hongcan, Director-General of the Anti-Monopoly and Anti-Unfair Competition Enforcement Bureau of the SAIC, the guiding enforcement principles for regulating e-commerce giants should be under principles of prudence and acceptance.⁶

For companies in the internet industry and companies using internet as their sales channel, we suggest:

- Prudently adopting "online" or "offline" channel restriction in distribution agreements;
- Taking non-traditional competition factors into account in evaluating the company's own market position; and
- Keeping an eye on the antitrust authorities' enforcement and legislation activities and make adjustment on internet business mode accordingly.

⁶ Available at: <http://finance.people.com.cn/n1/2017/1119/c1004-29654870.html>.

