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A Tale of Two Courts: Handling Market Definition in Abuse of Dominance Cases under Market Share-Based Statutory Power Presumptions in China and Korea

Yong Lim & Yunyu Shen[1]

I. INTRODUCTION

The decision by the Supreme People's Court of the People's Republic of China ("SPC") in the *Qihoo vs. Tencent* case[2] ("*Tencent*") is notable in many aspects starting from the fact that it is the SPC's first decision involving the country's Anti-Monopoly Law ("AML"). But, one eye-catching statement in the decision that commentators have been particularly quick to point out is the court's opening salvo in its reasoning that an explicitly and clearly defined relevant market is not necessary for every abuse of dominance case brought under Article 17 of the AML.[3] Other than hinting that the availability of evidence and relevant data, and the particular complexities of the market involved could all be factors in determining whether market definition is necessary,[4] the decision does not provide further guidance as to determine whether and when, if at all, market definition would be required for antitrust analysis in abuse of dominance cases.[5]

The unqualified and sweeping nature of the court's declaration on market definition may prompt some to believe that the SPC has embraced the renewed criticism on the futility of the market definition exercise,[6] and is on its way to eventually dumping market definition as a

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[2] SPC Judgment of October 8, 2014, (2013) 民三终字第4号.

[3] *See*, *e.g.*, David S. Evans & Vanessa Zhang, *Qihoo 360 v Tencent: First Antitrust Decision by the Supreme Court*, CPI ASIA COLUMN (Oct. 21, 2014) *available at* https://www.competitionpolicyinternational.com/assets/Uploads/AsiaOctober214.pdf; Susan Ning, Peng Heyue, Yang Yang, Qiu, Weiqing, Sarah Eder, & Guo Shaoyi, *The Supreme Court Goes Online with Anti-Monopoly Law Principles: A Review of Qihoo vs. Tencent Abuse of Market Dominance Case*, CHINA LAW INSIGHT (Nov. 12, 2014), *available at* http://www.chinalawinsight.com/2014/11/articles/corporate/antitrust-competition/the-supreme-court-goes-online-with-anti-monopoly-law-principles%ef%bc%9aa-review-of-qihoo-v-s-tencent-abuse-of-market-dominance-case/.

[4] *Tencent*, *supra* note 2, at 77. The decision states these factors as examples of specific circumstances of the case, which would determine whether a relevant market can be clearly defined.

[5] Nor does the decision explicitly qualify the above declaration in any other meaningful way (for example, limiting it to cases involving dynamic and innovative industries). *But*, *see*, XIANLIN WANG, RESEARCH ON CUTTING ISSUES IN ENFORCEMENT OF CHINA'S ANTI-MONOPOLY LAW 332-334, (2011) (in Chinese), and Yong Huang & Xiaojun Jiang, *Relevant Market Definition in the Internet Industry*, 6 LAW SCIENCE 92, 99 (2014) (in Chinese) (both arguing prior to *Tencent* that market definition should not be treated as essential in cases involving the Internet industry).

[6] *See*, *e.g.*, Louis Kaplow, *Why (Ever) Define Markets?*, 124 HARV. L. REV. 437 (2010).

clumsy partner in antitrust analysis for the more adroit and nimble direct analysis of anticompetitive effects. As further explained below, the authors believe that the embrace is short of a full one, likely just enough to enable the court to dance around the floor without tripping over market definition. And one of the reasons for this is the explicit statutory incorporation of market shares and market share-based presumptions of market power into the AML.[7]

This is in contrast with other major jurisdictions such as the United States and the European Union.[8] While U.S. courts continue to rely on market shares as an important factor in determining monopoly power after Judge Hand's holdings in *United States v. Aluminum Co. of America*[9],[10] nothing in the Sherman Act explicitly requires this nor does it provide for presumptions of market power based on market shares. This is the same for Articles 101 and 102 of the TFEU.[11]

However, China's AML is not unique in terms of such statutory embodiments. Korea's Monopoly Regulation and Fair Trade Act ("MRFTA") has long incorporated market shares and market share-based presumptions for market power (since 1990),[12] and the thresholds for presuming dominance are quite similar between the two statutes. In fact, shortly after the *Tencent* decision, the Supreme Court of Korea ("SCK") rendered its own judgment on the alleged abuse of dominance by NAVER Corporation ("Naver Corp"), which operates Naver.com, Korea's top search portal ("*Naver*").[13] Both cases shared the same outcome—the allegations were dismissed based on the failure to prove and establish market dominance and also illegal conduct.

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[7] While one should be careful not to overstate the significance of these statutory embodiments of market share-based presumptions, they maintain potency and legitimacy by virtue of existing within the statute unless courts and agencies deliberately choose to ignore them or otherwise degrade their legal importance in adjudicating cases. A famous example of this is the U.S. Supreme Court's interpretation of Section 1 of the Sherman Act, in which it essentially struck the word "every" out of the statute (Standard Oil Co. v. United States, 221 U.S. 1, 59 (1911)).

[8] In the United States, there is some disagreement over whether the "line of commerce" language in Section 7 of the Clayton Act should be interpreted to require market definition as ostensibly stated in *Brown Shoe* (Herbert Hovenkamp, *Markets in Merger Analysis*, 57 ANTITRUST BULL. 887, 888-900 (2012); Kaplow, *supra* note 6, at 513). This, however, does not seem to be the case for the Sherman Act. Rather, the view that market definition is necessary for monopolization cases under the Sherman Act seems to be predicated on perceived analytical necessity more than anything else (ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 227 (Jonathan I. Gleklen et al. eds, 7th ed. 2012) (hereinafter ANTITRUST LAW DEVELOPMENTS)). *But see* Kaplow, *supra* note 6, at 513 n.162 (noting that similar arguments could be made for Section 2, although "the inference from the statutory language is even weaker with the Sherman Act").

[9] 148 F.2d 416, 424 (2d Cir. 1945).

[10] ANTITRUST LAW DEVELOPMENTS, *supra* note 8, at 230.

[11] Treaty on the Functioning of the European Union. While the Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings (2009) OJ C 45/2 refers to market shares (¶¶ 13-15), the document's purpose is to provide for guidance on the Commission's priorities and does not refer to presumptions *per se*. The presumption of dominance based on a 50 percent market share by the ECJ has been developed as a judicial rule rather than through statutory interpretation (ALISON JONES & BRENDA SUFRIN, EU COMPETITION LAW, 327-9 (4th ed 2011)).

[12] Professors Elhauge and Geradin provide examples of other jurisdictions that also incorporate such market share-based presumptions in their competition law statutes, *see* (EINER ELHAUGE & DAMIEN GERADIN, GLOBAL COMPETITION LAW AND ECONOMICS 290 & n.70 (2nd ed 2011)).

[13] SCK Judgment of November 13, 2014, Case No. 2009*Du*20366.

The two Supreme Courts, however, diverged in the paths they took to come to that conclusion, which in part reflects differences in how they dealt with the statutory embodiments mentioned above. As the *Tencent* decision grants lower courts and agencies a certain amount of flexibility to further explore and choose different approaches for handling market definition issues, the Korean courts' approach in *Naver* is worth observing because it shows one real world possibility among an array of alternatives.[14]

II. BACKGROUND

A. Relevant Statutes

1. China

Article 17 of the AML defines a dominant market position as one held by an enterprise having the capacity to control the price, quantity, or other trading conditions of goods in the relevant market, or to hinder or effect any other enterprise from entering the relevant market. The following Article 18 states that a dominant market position shall be determined according to: (i) the market share of the enterprise in the relevant market, (ii) the state of competition in the relevant market, (iii) the capability of the enterprise to control the markets for selling the goods or procuring the needed raw materials, (iv) the financial and technical capabilities of the enterprise, (v) the degree other enterprises depend on the enterprise in transactions, and (vi) the degree of difficulty for other enterprises to enter the relevant market.

Article 18 ends with a catch-all clause whereby the arbiter shall review "other factors" relevant to the determination, and the SPC made it clear in *Tencent* that the determination of dominance was a result of a comprehensive evaluation of multiple factors in a case- and fact-specific manner.[15] Note that the statute explicitly refers to a dominant market position in the context of a "relevant market," which is defined earlier as the scope of goods or territory within which enterprises compete against one another during a certain period of time for specific goods or services.[16] There is, however, no express requirement to define a relevant market in the statute.

Article 19 states the thresholds for presuming market dominance. An enterprise can be presumed to be dominant if: (i) its market share accounts for one-half or more of the relevant market; (ii) together with another enterprise, the combined market share accounts for two-thirds or more of the relevant market; or (iii) together with two other enterprises, the combined market share accounts for three-quarters or more of the relevant market. An enterprise with a market share less than 10 percent is excluded from the presumption. Article 19 makes it clear that this is a rebuttable presumption, and an enterprise that is presumed to have dominance can overturn the presumption by presenting proof otherwise.

[14] As a clarifying note, the authors' focus in this paper is how the Chinese and Korean Supreme Courts have chosen to deal with the statutory incorporation of market shares and market share based-presumptions. We do not base our observations on a particular opinion on whether one should retain market definition in antitrust analysis for abuse of dominance cases.

[15] *Tencent*, *supra* note 2, at 98.

[16] AML Article 12.

2. Korea

Article 2(vii) of the MRFTA defines a market-dominant enterprise as one that has the market position to determine, maintain, or alter the price, quantity, quality, or other terms of trade of goods or services unilaterally or together with another enterprise as a supplier or buyer within a "particular area of trade." A particular area of trade is further defined as an area where, by the object, stage, or territory of trade, a relationship of competition can or does exist.[17]

While the MRFTA itself does not explicitly refer to a "relevant market" or demand defining such a market, Korean courts have consistently interpreted the statutory language ("particular area of trade") to require market definition for analysis of abuse of dominance cases.[18] A claim of abuse of dominance can theoretically be dismissed upon failure to properly define the relevant market, since this would mean that the plaintiff or the KFTC has failed to affirmatively establish the dominant market position of the defendant or respondent.

The first reference to market shares in the context of abuse of dominance comes right after the statute defines a market-dominant enterprise. It states that market shares, the existence and extent of market entry barriers, the relative size of competitors, among other things, shall be comprehensively considered in determining whether an enterprise is dominant in the market.[19]

A presumption of dominance based on market shares is provided in Chapter II of the MRFTA, which specifically deals with abuse of dominance. According to Article 4, an enterprise with the following market shares in a particular area of trade shall be presumed to be a market dominant enterprise in accordance with Article 2(vii): (i) the enterprise has a market share of 50 percent or more, or (ii) if three or less enterprises (including the one alleged to have market dominance) have a combined market share of 75 percent or more, but excluding enterprises with a market share of less than 10 percent. This presumption is rebuttable. Yet, according to the knowledge of the authors, there has not been a single case where the courts have overturned the presumption once established within a properly defined relevant market.

B. The Cases[20]

1. Tencent[21]

China's top online security software provider Qihoo brought claims against leading instant messaging ("IM") service provider Tencent under Article 17 of the AML, arguing that

[17] MRFTA Article 2(viii).

[18] *See*, *e.g.*, Seoul High Court Judgment of Oct. 8, 2009, Case No. 2008*Nu*27102, 20-21 (hereinafter "SHC Decision"). This was the lower court decision in *Naver*.

[19] MRFTA Article 2(vii).

[20] For purposes of this paper, we omit findings by the courts that are not directly relevant to the present discussion (namely, the SPC's holdings on illegal tying and the SCK's holdings on undue support).

[21] In describing *Tencent*'s holdings in English, the authors have referred to, although not exclusively, the unofficial partial translation provided by Global Economics Group, LLC, *available at* http://archive.constantcontact.com/fs193/1111629548505/archive/1119449629439.html. The authors, however, take sole and full responsibility for the restatements and description provided in this paper. All references to the court's decision in the footnotes correspond to the original Chinese text, *available at* http://file.chinacourt.org/f.php?id=2331&class=file.

Tencent had wrongfully abused its dominance in the putative "integrated IM" service[22] market when it terminated interoperability between its IM service ("QQ") and Qihoo's security software, allegedly in an attempt to force users to abandon Qihoo's security software for competing products such as its own security software, QQ Doctor.[23]

The SPC rejected the market definition suggested by Qihoo. While declaring that an explicitly and clearly defined market is not always necessary for every abuse of dominance case, it nevertheless proceeded with a lengthy analysis on market definition and concluded that the proper relevant market in this case was the market for IM (including both integrated and non-integrated, and covering both PC and mobile) services in mainland China.[24] Based on the number of active users and the usage time and frequency, Tencent was found to have a market share exceeding 80 percent in this market,[25] which triggered a presumption of market dominance under Article 19 of the AML.

The court, however, had stated earlier that market shares only give a rough indication of market dominance, and that the significance of market shares as an indicator of market dominance should be determined on a case-by-case basis.[26] For the present case, the court noted that the internet industry exhibited highly dynamic competition and the boundaries of relevant markets were far less clear compared to other more traditional industries.[27] Accordingly, it cautioned against overstating the significance of market shares as an indicator of market dominance in this case, and stated that more attention should be paid to other factors such as market entry and the competitive impact of the defendant's conduct.[28] The court pointed to, among other things, the current innovative and dynamic state of competition in the market, continued market entry, and the actual effects of the alleged abuse (specifically, the rise in the number of users of rival products of QQ),[29] to find that Tencent did not have a dominant market position in the relevant market, in effect overturning the presumption under Article 19.[30]

At this point, the SPC could have dismissed the plaintiff's claims without further analyzing whether Tencent had engaged in abusive (exclusionary) conduct. The court acknowledged this, but continued to analyze whether Tencent's conduct constituted an abuse of a dominance.[31] Interestingly, the main reason provided by the court for this additional (full)

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[22] Full-featured IM service, which integrates text, audio, and voice functionalities.

[23] Interoperability was restored the very next day following after the Chinese Ministry of Industry and Information Technology circulated a notice criticizing both companies (*Tencent and Qihoo Accept Criticism from MIIT and Apologize to Netizens Again*, XINHUANET, Nov. 22, 2010, *available at* http://news.xinhuanet.com/internet/2010-11/22/c_12800122.htm). For a fuller description of the case including Qihoo's bundling claim, *see* David S. Evans, Vanessa Zhang, & Howard Chang, *Analyzing Competition among Internet Players: Qihoo v. Tencent*, CPI ANTITRUST CHRON. (May 2013).

[24] *Tencent*, *supra* note 2, at 98.

[25] *Id.* at 100.

[26] *Id.* at 98.

[27] *Id.* at 99.

[28] *Id.*

[29] *Id.* at 100-105. This was in accordance with Article 18 of the AML, which lists factors that shall determine the existence of a dominant market position.

[30] *Id.* at 106.

[31] *Id.*

analysis was that the boundaries of the relevant market and the existence of market dominance remained relatively unclear in this case,[32] despite having just upheld the lower court's judgment that Tencent lacked dominant market power. The court eventually found that Tencent's actions had not significantly eliminated or restricted competition, and stated that this conclusion supported the court's prior finding that Tencent did not have dominant market power.[33]

2. *Naver*[34]

This case originated from a decision by the Korea Fair Trade Commission ("KFTC") that Naver Corp had abused its dominant market position.[35] Naver Corp had entered into indexing agreements with certain online video content providers ("CPs"), which prohibited these CPs from placing, without consultation with Naver Corp, pre-roll advertisement clips[36] in their content shown through Naver.com's search results.[37] Naver Corp's justification for such terms was that the pre-roll ads could degrade the user experience of Naver.com's search results, and thus the restrictions were necessary to ensure the quality its user experience.[38]

The KFTC, however, rejected the justification and ruled that such agreements had harmed the CPs, and had weakened competition from CPs in the online advertising market by unduly restricting their business activities, thereby maintaining and strengthening Naver Corp's dominance in the putative relevant market.[39]

In reaching this conclusion, the KFTC determined that the relevant market was the internet portal market, consisting of a collection of portal sites that provided at a minimum search ("1S") as well as content, communication, community, and commerce ("4C") services.[40] In this putative "1S-4C" internet portal market, the KFTC found that Naver Corp's market share was 48.5 percent, and found Naver Corp to hold a dominant market position based, among other things, on the presumption clause in Article 4 of the MRFTA.[41]

In discerning Naver Corp's market share, the KFTC rejected widely used industry metrics such as "unique visitors" or users' "average duration time" as unreliable,[42] and based its

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[32] *Id.*

[33] *Id.* at 111.

[34] All references to the *Naver* decision in the footnotes correspond to the original Korean text.

[35] KFTC Decision, No. 2008-251, Case No. 2007*Seo-Ee*3007, Aug. 28, 2008 (hereinafter "KFTC Decision"). All references to the KFTC decision in the footnotes correspond to the original Korean text.

[36] Pre-roll ads are advertisement clips shown prior to the start of the video.

[37] KFTC Decision, *supra* note 35, at 9-10.

[38] *Id.* at 22; SHC Decision, *supra* note 18, at 3, 19.

[39] KFTC Decision, *supra* note 35, at 20-22.

[40] *Id.* at 12-14. As a result, online portal or search sites that did not provide one or more of the 1S-4C features above were excluded from the relevant market.

[41] *Id.* at 15-16. According to the KFTC, the top three 1S-4C portal sites enjoyed a combined market share of 80.8 percent, therefore triggering the second presumption under Article 4.

[42] In contrast, the SPC accepted similar metrics in calculating Tencent's market share (*Tencent*, *supra* note 2, at 99). *See*, also, Wenming Yang, *Theoretical Reflection and Application Methods for Market Share Criterion Under the Identification of Dominant Market Position on Internet Company*, 3 J. NORTHWEST UNIV. (PHILOSOPHY & SOCIAL SCIENCES ED) 68, 73-74 (2014) (in Chinese), and Ming Ye, *Dilemma and Its Solution for Identifying a Market Dominant Position in the Internet Industry*, 1 STUDIES IN LAW AND BUSINESS 31, 35 (2014) (in Chinese) (both discussing the application of such metrics for cases involving the internet industry under the AML).

calculation on the total revenue of portal sites.[43] According to the KFTC, internet portal platforms operated in two-sided markets, which included one side facing advertisers.[44] Since a stronger user base on the side of users could ultimately translate into higher ad revenue on the other side, and Naver Corp's revenue enabled it to further procure and develop popular content to users, which would in turn increase its user base, the KFTC deemed that revenue was a proper metric for calculating market shares.[45]

On appeal, the Seoul High Court held that the KFTC had erred both in its definition of the relevant market (namely excluding other portal or online sites which did not provide the full set of 1S-4C services, but nevertheless provided competition to Naver Corp), and also its reliance on revenue figures to calculate market shares.[46] According to the Seoul High Court, the intermediary (platform) market for connecting CPs and users would have been the proper relevant market, and the extent CPs relied on Naver.com as a channel to connect with and deliver their content to end users was a critical factor in determining whether Naver held dominant market power.[47] In sum, the KFTC had failed to properly define the relevant market and establish Naver Corp's dominance.

Instead of concluding the analysis at this point, the Seoul High Court proceeded to find that Naver Corp's conduct did not constitute abusive behavior even when assuming, *in arguendo*, that Naver Corp was dominant. It pointed to the fact, among others, that: (i) Naver Corp also did not place pre-roll ads in its own video content, (ii) the restriction was not an outright prohibition but a duty to consult with Naver Corp, (iii) there was reasonable justification for limiting ads that interfered with the user experience to a certain extent, (iv) CPs that did not wish to accede to Naver Corp's terms could provide their content through other internet portal sites, and (iv) that at least one major CP had ended up placing pre-roll ads despite the agreement.[48]

After reiterating its long-held position that the relevant market must be specifically defined in order to determine whether an enterprise holds a dominant market position,[49] the SCK entirely concurred with the lower court in its holdings on how the KFTC had erred in defining the market and calculating market shares based on total revenue.[50] It also agreed with the lower court's assessment that it was difficult to view Naver Corp's conduct as having been carried out with the purpose or intent of maintaining or strengthening monopoly power, and as being one that objectively raised concerns of anticompetitive effects, thus rejecting the KFTC's arguments that Naver Corp had abused its dominance.[51]

[43] KFTC Decision, *supra* note 35, at 16.
[44] *Id.* at 6-8.
[45] *Id.* at 16.
[46] SHC Decision, *supra* note 18, at 19-25.
[47] *Id.* at 22.
[48] *Id.* at 25-28.
[49] *Naver*, *supra* note 13, at 3.
[50] *Id.* at 3-5.
[51] *Id.* at 5-7.

III. HANDLING MARKET DEFINITION UNDER MARKET SHARE-BASED STATUTORY PRESUMPTIONS OF MARKET POWER IN ABUSE OF DOMINANCE CASES

A. Market Definition and Statutory Presumption of Market Dominance

Compared to a prospective merger, one would tend to think that an allegation of an abuse of dominance could lend itself more readily to the argument that one should turn away from market definition and its market share-derived power inferences, and focus on direct evidence of market power, including anticompetitive effects. After all, if the allegation were true, the abusive behavior would have already harmed competition and the effects would likely be cognizable.[52]

There are a few wrinkles to this observation. The first one is that competition laws sometimes allow for abuse of dominance claims that target behavior that have a high propensity or danger of harming competition, even if the harm has not specifically materialized.[53] Another wrinkle is the possible benefits of maintaining the two-step analysis of finding dominance and then identifying competitive harm.

If the above argument were to be carried so far as to conflate both steps into one—essentially substituting the assessment of anticompetitive effects for a finding of dominance, there could be cases where a dominant firm would be over-exonerated by being found not only to have engaged in pro-competitive or otherwise legal conduct, but also lacking market power in the first place.[54] This could conceivably lead to false negatives for other illegal conduct committed at the same time (but not adjudicated in the same case), and under-deterrence against future abuses of the firm's dominant market power.[55]

Yet another wrinkle, and the focus of this article, is when plaintiffs or competition agencies present arguments relying on market share-based statutory presumptions. In order to properly adjudicate contesting claims involving a presumption of dominance based on market shares, the court would have to delineate the boundaries of the market and measure the accused's market share therein.

Whether relying on a presumption of dominance, and defining the market in this process, would be more feasible for the plaintiff (or competition agency) than proving market dominance through other direct or indirect evidence will depend on the specific facts and evidence available for a given case. But, experience shows that a presumption clause will often be utilized, if anything, to bolster the strength of an abuse of dominance claim.

According to a search of the KFTC website database, among the ten most recent abuse of dominance decisions rendered by the KFTC, a total of seven relied in part on the presumption

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[52] J. Douglas Richards, *Is Market Definition Necessary in Sherman Act Cases When Anticompetitive effects Can Be Shown With Direct Evidence?*, 26(3) ANTITRUST 53 (2012).

[53] This is the case in Korea, where the courts have recognized that a significant danger of harming competition is sufficient for abuse of dominance claims (*see*, *e.g.*, *supra* note 13 at 6).

[54] Kaplow, *supra* note 6, at 498-501.

[55] *Id.* at 501.

under Article 4 to find dominant market power.[56] In the remaining three cases, it was evident that the respondents enjoyed an absolute (100 percent) or virtual monopoly, thus making a presumption unnecessary. We are not aware of any particular reason to believe that the experience in China would be radically different.[57]

If the Chinese courts will be encountering claims invoking a presumption of dominance, and will likely be required to delineate markets in the process of assessing them, how should one square the SPC's holding that the relevant market need not necessarily be clearly defined in an abuse of dominance case with this reality? We believe that, when taken together with the court's overall determination of market dominance, the aforementioned holding is less of a statement about skirting market definition itself, but more about avoiding the possible pitfalls that can arise during the market definition exercise.

The logical and analytical merits and demerits of defining a relevant market have been extensively discussed in antitrust literature, and continue to generate commentary.[58] Regardless of where one stands on the issue, however, the fact that the market definition exercise in practice can create problematic outcomes seems non-controversial.[59] The core practical concern about the market definition exercise is its potential to either stunt a proper analysis of the facts (particularly, but not always, when market definition is treated as a threshold issue) or force the parties and courts to contort their analyses to conform to defined market boundaries (often caused by the rigid "in-or-out" (of the relevant market) nature of the exercise) that can either lead to seemingly tortured logic or inconsistencies fatal to the claims of either party.[60]

As it turns out in *Tencent*, the SPC from the get go seems to have realized the need to maintain a modicum of flexibility in approaching market definition, particularly in the face of claims relying on a statutory presumption of market dominance. The court, however, did little to instruct on how this flexibility should be exercised, and thus we are left to ponder the possible approaches.[61] In the following, we examine an array of possible approaches that could be taken by Chinese courts (and agencies) for market definition, with an eye on how the Korean courts have approached this matter in the past and more recently in *Naver*.[62]

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[56] *See* http://www.ftc.go.kr/laws/book/judgeSearch.jsp. The search was conducted on January 15, 2014. Decisions involving consent decrees, reassessment of administrative fines, or duplicative cases (totaling six cases) were excluded as non-relevant. The dates of the cases reviewed ranged from Jun. 18, 2008 up to Mar. 26, 2012.

[57] In *Tencent*, Qihoo also utilized AML Article 19 in an attempt to establish Tencent's alleged market dominance.

[58] For an example of a recent debate, *see* articles in 57 ANTITRUST BULL. (2012) (SPECIAL ISSUE: LOUIS KAPLOW'S WHY (EVER) DEFINE MARKETS?).

[59] *See*, *e.g.*, Duncan Cameron, Mark Glick, & David Mangum, *Good Riddance to Market Definition?*, 57 ANTITRUST BULL. 719, 720 (while defending the use of market definition, nevertheless pointing out the imperfections of market definition as a tool to measure market power).

[60] *Id.* at 721.

[61] One could interpret this lack of further guidance as being intentional on the part of the SPC; for example, to allow maximum flexibility for itself and lower courts in the future, thereby enabling case law to develop in a manner that comports with the specific facts and circumstances of the case at hand. This approach may be particularly prudent for a court that is staking out its position on antitrust matters for the first time.

[62] The following list of approaches is not meant to be an exhaustive one nor does it purport to identify and list the most preferable approaches.

B. The Good, The Bad, and The Ugly: Possible Approaches to Market Definition by the Chinese Courts following Tencent

1. The Bad: The Unlikely Extremes

a. Completely dispensing with market definition

The most radical approach from the perspective of the statutory language would be to drop market definition completely. While this would be the preferable approach for those disenchanted with the market definition paradigm, this approach would require the courts to legislate by effectively striking Article 19 from the AML in the form of deliberately ignoring market share-based presumption claims.[63] There is, however, another way to achieve a similar result. One could instead effectively render the market definition exercise meaningless by "backing-in" to market definition only after analyzing the effects of the conduct.[64]

One could conceivably take the SPC's holding that an explicitly and clearly defined market is not necessary for every abuse of dominance case, without further elaborating when it might be necessary, as an effective invitation for courts to ignore market definition in practice. The SPC's remarks that the lack of anticompetitive effects further informed and supported its finding that Tencent lacked a dominant market position,[65] and that market shares do not always have to be assessed in determining market dominance (in other words, market dominance may be determined based on factors other than market shares)[66] would seem to even hint to a backing-in approach.

However, there are reasons to doubt such a proposition. First of all, the SPC, despite stating the above, proceeded nonetheless with an extensive analysis to define the market in *Tencent*.[67] This rebuts the idea that the SPC will allow lower courts to dispense with market definition completely.

Second, from the decision's holding, it does not look like the SPC has wholeheartedly embraced the criticism of the current market definition paradigm despite acknowledging its limitations. In its decision, the court affirmed both the general and specific applicability of the HMT to the case (albeit in a different perspective from the lower court),[68] and its analysis

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[63] We characterize this approach as "bad" due to this aspect, and not based on a particular disagreement with criticisms of the market definition paradigm.

[64] Some have argued that this is what U.S. courts often do in practice, at least in merger cases (Peter C. Carstensen, *Introduction*, 57 ANTITRUST BULL. 655, 657 (2012); Kaplow, *supra* note 6, at 509 (citing FTC v. Staples, Inc., 970 F. Supp. 2d 1066 (D.D.C. 1997) as an example)).

[65] *Tencent*, *supra* note 2, at 106.

[66] *Id.* at 111. This means that the courts have some discretion in picking and choosing from the factors listed in Article 18 in their assessment of market dominance. This would be the same for competition agencies or plaintiffs, raising at least theoretically the possibility that direct evidence of anticompetitive effects could be accepted as sufficient to prove market dominance under AML Article 18(6) without defining a relevant market.

[67] *Id.* at 77-98.

[68] *Id.* at 79-81.

essentially follows conventional market definition practice by examining cross-elasticities between proffered substitutes.[69]

Third, while the court deemphasized the importance of market shares and the inference to be drawn from them,[70] the court had to address Qihoo's presumption argument under Article 19, define the relevant market in this process, and calculate Tencent's market share therein. The repeated references to "relevant market" in the AML both in and out of the context of abuse of dominance, and the fact that the statute expressly cites market shares as one of the factors to determine the existence of market dominance, also augur against market definition being pushed aside completely.

In the case of Korea, the SCK has made it abundantly clear that market definition is an important step for analysis in abuse of dominance cases under the MRFTA.[71] It also recently ruled that one cannot substitute an analysis of anticompetitive effects for market definition, effectively rejecting a backing-in approach.[72] As of now, the market definition paradigm seems to be firmly imbedded into the fabric of analysis under the MRFTA, which is not surprising given the court's interpretation of the statutory language that dominance be found in the context of a "particular area of trade."[73] The existence of Article 4 would also likely serve as a material impediment to completely abandoning market definition barring legislative action.

b. Enforcing market definition as a threshold issue in every case

This is the other side of the extreme, which could exacerbate potential problems caused by the market definition exercise mentioned above.

From the *Tencent* decision, it would seem to be fairly clear that the SPC does not intend to make market definition a threshold issue in every abuse of dominance case. It is unclear whether this will be the rule or the exception. But this observation is buttressed by the SPC's statement that courts should redefine the relevant market *ex officio* to the extent possible if they do not agree with the parties' arguments on the market definition, rather than directing the lower courts to dismiss the case if there are flaws in the plaintiff's proffered definition.[74]

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[69] *Id.* at 81. The Anti-Monopoly Committee of the State Council's Guidelines on Defining Relevant Markets (May 24, 2009), *available at* http://www.gov.cn/zwhd/2009-07/07/content_1355288.htm, also expressly refers to the HMT as a prominent method of market definition, and states its importance in the enforcement of the AML. This at least implies that market definition may continue to play an important role in competition law enforcement by Chinese competition agencies.

[70] *Tencent*, *supra* note 2, at 99.

[71] *See*, *e.g.*, SCK Judgment (*En Banc*) of Nov. 22, 2007, Case No. 2002*Du*8626; SCK Judgment of Dec. 11, 2008, Case No. 2007*Du*25183 (both cases were cited by *Naver*, *supra* note 14, at 3). *See*, also, Sung-Hoon Kim, *Regulation of Monopoly and Oligopolies in* 30 YEARS OF THE MONOPOLY REGULATION & FAIR TRADE LAW 167, 188 (Ohseung Kwon ed., 2011) (in Korean) (noting that the above 2002*Du*8626 judgment had confirmed what was already established theory regarding the relevant market).

[72] SCK Judgment of Apr. 26, 2012, Case No. 2010*Du*18703. Although this was a horizontal collusion case, it seems more likely than not that the SCK would also reject a similar approach for abuse of dominance cases.

[73] Jae-Hoon Cheong, *Undue Collusion and Defining the Relevant Market – Supreme Court of Korea, Judgment of April 11, 2013, Case No. 2012Du11829, etc.*, 62(11) *BUBJO* 283 (2013) (in Korean) (discussing the SCK's decision that market definition is required for even cases which would have received *per se* treatment under U.S. antitrust law).

[74] *Tencent*, *supra* note 2, at 78.

Meanwhile, on its face, statements by the SCK that market definition is a necessary step in the analysis to establish market dominance may seem to follow this approach. However, a closer look at *Naver* suggests otherwise, as elaborated further below.[75]

2. The Ugly: The Confounding Tests

a. The "difficulty" test

In its holdings on the necessity of a clearly defined market, the SPC refers to limitations in evidence and data and the complexities of the case and market competition as factors that could render a clear definition of the relevant market "extremely" difficult.[76] Based on such references, one might interpret the court's holding as meaning that market definition might not be strictly required when it is *difficult* to define the relevant market based on the factors mentioned above (or other relevant factors that could complicate market definition, *e.g.*, markets with goods provided free of charge[77]).

The problem with such an approach is that market definition is often a challenging endeavor so the issue would become a matter of degree. The test then quickly becomes vague, confusing, and virtually impossible to administer in a consistent and coherent manner, because perceptions on the level of difficulty are subjective in nature. As such, this approach seems neither feasible nor recommendable.

b. The "character" test

Some may also suggest that the SPC meant to allow dispensing with market definition (or at least deemphasizing it) in specific industries exhibiting certain characteristics (*e.g.*, where innovation is a critical element of competition). One might conceivably base this suggestion on the court's passing comment that the internet industry, in which the relevant market was situated, exhibited highly dynamic competition and the boundaries of relevant markets were far less clear compared to other more traditional industries.[78]

As noted earlier, the SPC did not explicitly qualify or limit the scope of its declaration that a clearly defined market is not always required to a particular industry or market, and one would expect the court to have made its intent clear if it had wished to do so. Moreover, such a test would quickly fall into disarray once lower courts tried to apply it to specific cases. Trying to discern which industries qualify as "non-traditional" industries, or how important innovation or

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[75] In the recent *Dong-A Pharmaceutical* case, the SCK upheld a lower court's decision, which declined to vacate the KFTC's corrective order against the plaintiff regardless of whether the KFTC had erred in defining the market, on the basis that the plaintiff's conduct was found to have harmed competition even in the broader market definition suggested by the plaintiff (SCK Judgment of Feb. 27, 2014, Case No. 2012*Du*27794, 5). The lower court did not affirmatively adopt, or for that matter, reject one or the other definitions suggested by the parties (Seoul High Court Judgment of Oct. 31, 2012, Case No. 2012*Nu*3035, 5). This was, however, a horizontal collusion case, and the SCK may be reluctant to apply the same logic to abuse of dominance cases.

[76] *Tencent*, *supra* note 2, at 77.

[77] The SPC in *Tencent* defined the relevant market despite the fact that IM services are generally provided free of charge. However, this aspect has sometimes led some courts to rule that market definition is not possible when services are provided free of charge (*see*, *e.g.*, Kinderstart.com LLC v. Google, Inc., No. C 06-2057 JF (RS) at *5 (N.D. Cal. Mar. 16, 2007)).

[78] *Tencent*, *supra* note 2, at 96.

some other characteristic of the industry would have to be in order to ignore market definition, could easily lead to contradictory outcomes even for seemingly identical industries, and would fail miserably in providing coherent guidance to companies that wish to avoid liability under the AML. This test seems no less confounding than the difficulty test above.

3. The Good (but Possibly Dangerous?): Approaches Showcased in *Naver* and *Tencent*

a. *Naver*: Avoiding Type II errors by engaging in complete analysis

Perhaps because of Korea's earlier adoption of competition law, the Korean courts seem more orthodox in their approach to the market-definition paradigm compared to the SPC. As mentioned above, market definition has been espoused by the courts as a necessary step in the analysis to determine market dominance. The courts have also adhered to the two-step analysis of market dominance (market power) and anticompetitive effects, treating them as separate and sequential stages of analysis.[79] Under such circumstances, the more one treats market definition as a threshold issue, the specter of Type II errors (false negatives) increases, since an error in defining the market (however small) by the competition authority or plaintiff may result in a rejection of their claims despite actual evidence of anticompetitive harm.

In *Naver*, the KFTC's claims were in tatters—it was found to have erred in defining the market and calculating market shares, and the presumption of dominance it had relied on had crumbled in the process. As mentioned previously, the courts did not, however, choose to conclusively overturn the KFTC's prior ruling right away. They labored on to analyze the competitive effects of the conduct and only after confirming that there was no evidence of anticompetitive harm did they rescind the KFTC's decision against Naver Corp. Such an approach would allow the court to avoid Type II errors that could be caused by market definition.

According to our reading of *Tencent*, nothing would seem to bar lower courts from continuing their analysis despite flaws in the parties' market definition. In fact, (i) the SPC's openness to determining market dominance without considering market shares (at least theoretically),[80] (ii) the court's position that it may redefine the relevant market *ex-officio* if the proffered definition is flawed,[81] and (iii) the possible inclusion of direct evidence of anticompetitive effects as a factor under Article 18(6) together would seem to open the door for such an approach.

Anticompetitive effects were found to be lacking in both *Naver* and *Tencent*, which exonerated the accused firms. But what about cases where there is sufficient evidence of anticompetitive harm? Several U.S. courts have taken the position that in the presence of direct evidence of monopoly power (*e.g.*, actual evidence of price increase or output reduction), market

[79] *See* judgments cited in *supra* note 71.
[80] *Tencent*, *supra* note 2, at 111.
[81] *Id.* at 78.

definition is not necessary in a monopolization case.[82] *Tencent* certainly seems open to this approach based on its repeated statements that the competitive impact of the alleged abusive behavior can inform the determination of dominance.

In the case of Korea, the SCK's decision in the *Dong-A Pharmaceutical* case[83] could arguably be viewed as a broader example of this approach. However, the SCK's statements on market definition as a necessary step for determining market dominance, and the fact that it has maintained a distinction between the elements of market dominance and competitive harm in abuse of dominance cases, would likely make it difficult for courts to completely forgo market definition. The rejection of a backing-in approach of defining the market based on evidence of anticompetitive effects, albeit once again in a horizontal collusion case, also supports this observation.

On a separate note, there is a question whether the SPC may have been too quick in allowing courts to infer a lack of dominant market power from a concomitant lack of (evidence of) anticompetitive effects without any further qualification. While the facts and evidence described by the courts in *Tencent* would seem to support a finding that Tencent lacked dominance in the putative market, the fact that the conduct was carried out for only a single day could beg the question of whether anticompetitive effects might have been visible if it had continued for a more prolonged period of time.

As discussed earlier, there are risks to conflating the elements of market dominance and anticompetitive effects, particularly in a scenario where evidence of anticompetitive effects are lacking. While the outcome should certainly be a rejection of liability in such a case, this would not necessarily mean that the firm lacked market power.

b. *Tencent*: Avoiding Type I errors by allowing imprecisely defined markets

A careful reading of *Tencent* suggests that perhaps the true meaning of the SPC's holding on market definition was not that courts may dispense with market definition (even in limited cases) despite suggestions otherwise.[84] Instead, the court may have meant to convey that, while market definition is a normal step of the analysis (which would particularly be the case when confronted with a claim invoking Article 19), one may proceed to determine market dominance (including calculating market shares for assessing claims involving Article 19) on the basis of an *imprecisely* defined market, *i.e.*, one without sharply delineated boundaries.

The SPC did not declare that defining the market is unnecessary *per se*, but that the relevant market does not necessarily have to be explicitly and clearly defined in every abuse of dominance case.[85] The fact that Qihoo had argued in its appeal that the Guangdong High People's Court had erred by failing to clearly and precisely define the market is informative in

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[82] *See* Broadcom Corp. v. Qualcomm Inc., 501 F.3d 297, n.3, and other examples cited in ANTITRUST LAW DEVELOPMENTS, *supra* note 8, at 229 n.20. The U.S. Supreme Court also took this position in FTC v. Ind. Fed'n of Dentists, 476 U.S. 447, 460-61 (1986) for Section 1 of the Sherman Act.

[83] *See* n.75.

[84] Ning et al., *supra* note 3, at 2 (stating that market definition is not an "essential step" for abuse of dominance cases after *Tencent*).

[85] *Tencent*, *supra* note 2, at 77.

this regard. Furthermore, the SPC's discussion on whether to expand the definition of the relevant market to include other internet platforms is indicative of such an approach. The court declined to affirmatively define the relevant market as the internet platform market,[86] which later meant that internet platforms (other than those providing IM services) were not considered in calculating the market share of Tencent under Article 19. At the same time, however, the court did not completely exclude such platforms from the analysis. Instead, it stated that while it would not principally consider competition from internet platforms in defining the relevant market, it would nonetheless consider the competitive constraints provided by such platforms in assessing Tencent's position in the market.[87]

It had good reason to do so. While it seemed likely that such platforms could exert competitive constraints on Tencent (particularly in terms of competing for the attention of users),[88] simply including all internet platforms in the relevant market may have likely resulted in an understatement of Tencent's actual market power.[89] Faced with the in-or-out problem of market definition for internet platforms, the SPC decided *out* for Article 19 (calculation of market shares), but *in* (at least to some extent) for the final determination of market dominance under Article 18. Its genius was in utilizing Article 18's non-exclusive list of factors (and likely the catch-all clause in Article 18(6)) for determining dominance to recognize potential competitive pressure on Tencent that would have been difficult to fully capture in the market definition exercise.[90]

By defining the relevant market to be the IM services market, the SPC was now confronted with a significant market share that triggered a presumption of dominance. Because a finding of dominance in the first stage of the analysis can color the court's following assessment of competitive harm,[91] such presumptions may entail concerns of Type I errors (false positives). This time the SPC, armed with evidence under other factors cited in Article 18 including competitive pressure outside of the defined market (*e.g.*, internet platform competition), overturned the presumption and concurred with the lower court's decision that Tencent lacked a dominant market position.[92]

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[86] *Id.* at 91-92.

[87] *Id.* at 93.

[88] *See* David S. Evans, *Attention Rivalry Among Online Platforms*, 9(2) J. COMPETITION L. & ECON. 313 (2013), *available at* http://jcle.oxfordjournals.org/content/9/2/313.full.pdf+html?sid=fd6b5ae9-2c16-4f2f-8395-d8f3b23773b5, for a fuller discussion on characterizing competition in the online industry as one for attention.

[89] *Tencent*, *supra* note 2, at 92.

[90] To the authors' knowledge, the SCK has not taken such an approach in past cases, and there is no indication that this is a real possibility in the future. That being said, *Tencent* does make one ponder whether the SCK could also interpret the factors for determining dominance in MRFTA Article 2(vii) to allow for a determination without (primarily) considering market shares.

[91] Kaplow, *supra* note 6, at 498 (noting that "many worry that a finding of substantial market power will automatically, or at least too readily, lead to condemnation, even when no improper behavior is present.")

[92] It seems more likely than not that the force of a presumption of dominance under Article 19 will continue to remain weak since the plaintiff (or competition agency) may well have to contend again with certain facts and evidence, which it had managed to exclude from the analysis during the market-definition stage, when the court makes its final assessment of dominance under Article 18.

Utilizing imprecisely defined markets may allow future courts to avoid the problems ensuing from the in-or-out problem of market definition, and also overcome Type I errors in cases where a presumption of dominance has been triggered. This approach would also allow courts and the parties to avoid being forced into contorted arguments to adhere to a particular definition of the market by providing flexibility in determining market dominance.

However, this approach is not without its dangers. The effective bifurcation of market definition (essentially allowing differently defined markets for Articles 18 and 19) through blurring the boundaries of the relevant market could result in confusion when analyzing the possible competitive harm of the behavior since courts may feel unsure which definition to follow. Also, until the courts (or perhaps to be more accurate, economists) come up with a reliable and coherent method to properly weight the competitive restraints provided by competition at the fringe or near the fuzzily defined market boundary, utilizing imprecisely defined markets may prove to be insufficient in overcoming the potential pitfalls of the market definition exercise. In addition, allowing impreciseness can introduce much needed flexibility, but it can also entail confusion and unpredictability.[93]

IV. CONCLUDING REMARKS

We expect the SPC to have opportunities to clarify its holding in *Tencent* in the future. However, abuse of dominance cases tend to be a rarer breed within the antitrust lexicon, and it may take some time until the SPC finally meets such an opportunity, even if it wishes to do so. Until then, the lower courts and competition agencies will have to craft their own paths toward handling market definition while confronting claims on presumptions of dominance.

The forgoing discussion sheds light on some of the paths that the lower courts may wish to consider, and possibly choose to explore. What is clear from the above is that there remains much work to be done, particularly if one takes the *Tencent* holding to mean that the courts will now entertain imprecisely defined markets in their analysis. It is one thing to allow for a pinch of impreciseness in a single case to obtain the right amount of seasoning. It is a completely different thing to introduce indiscriminate sprinklings of fuzziness into market definition and create a stew of uncertainty. The challenge is how to be discreet, and the irony is that the SPC may well be asked to draw the line once again.

[93] As a final note, any shift away from the market-definition paradigm, if anything, increases the importance of properly conducting the analysis of competitive harm to avoid both false positives and negatives. One easy mistake to make is equating harm to the business of a particular competitor or group of competitors as harm to competition. Fortunately, both the SPC and SCK seem to have managed to avoid this mistake by expressly rejecting arguments that harm to a particular business or competitor was sufficient to establish abusive behavior (*Tencent*, *supra* note 2, at 108; *Naver*, *supra* note 13, at 6-7).

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MOFCOM Simple Cases: The First Six Months

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MOFCOM Simple Cases: The First Six Months

Marc Waha[1]

I. INTRODUCTION

After the advent of the merger control regime under the Antimonopoly Law in 2008, "MOFCOM merger approvals" quickly became synonymous with transaction delays, costly fees, and significant administrative burden. Even in transactions that did not present competition issues, the requirement to obtain Chinese merger control approval was often a matter for discussion at Board-level. Investment bankers and other transaction planners were brought in to advise on the intricate art of gaining prompt clearance from the Antimonopoly Bureau of the Ministry of Commerce ("MOFCOM"), even for simple transactions.

This all changed in 2014, with the introduction of a simplified merger review procedure in April. In the space of six months, in straightforward cases a "MOFCOM merger approval" has gone from a shorthand for administrative headache and significant deal delays to a reference to an efficient process delivering prompt and largely predictable outcomes.

The new procedure is a clear success. The first eligible transaction, the acquisition by Rolls-Royce of the stake held by Daimler AG in the companies' Rolls-Royce Power Systems joint venture, was accepted on May 22 and cleared within 19 days.[2] As 2014 came to a close, 83 concentrations had been accepted under the new rules, 69 of which had been cleared within 27 days on average.

Parties were quick to make use of the new rules. Three months after they were introduced, roughly half of all merger filings were made under the new procedure. This proportion increased even further during the last quarter of the year, with close to two-thirds of all merger decisions adopted during the period following a simplified procedure.[3]

In this brief article we take stock of where things stand a little over six months after the first case was accepted for simplified treatment, and we identify some remaining challenges.

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[2] *See* the public notice issued by MOFCOM on 22 May 2014, *available at* http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201405/20140500597172.shtml; for the clearance date, *see* MOFCOM's list of unconditionally approved transactions during the third quarter of 2014, *available at* http://fldj.mofcom.gov.cn/article/zcfb/201410/20141000755915.shtml.

[3] Of 75 decisions adopted during the fourth quarter of 2014, 48 involved the simplified procedure. For MOFCOM's list of unconditionally approved transactions during the last quarter of 2014, *see* *http://fldj.mofcom.gov.cn/article/zcfb/201501/20150100863949.shtml*.

II. AN EXPEDITED PROCEDURE

Two legal instruments organize the simplified procedure: MOFCOM's *Interim Regulation on the Application of Simple Case Criteria to Concentrations of Undertakings* of February 12, 2014[4] and its *Guidance Note on Notifications of Simple Cases of Concentrations of Undertakings (Trial)* of April 18, 2014.[5] The primary purpose of these rules is twofold—on the one hand, to determine the eligibility criteria for transactions to qualify as "simple cases;" and, on the other hand, to set out simplified disclosure requirements that apply to notifications of simple cases.

Neither document contains much by way of provisions concerning a simplification of the merger review procedure. On the contrary, the *Guidance Note* provides for a more complex review procedure that applies in simple cases. Articles 8 and 9 of the *Guidance Note* provide for a ten-day public consultation process allowing third parties to comment on the eligibility of the notified transaction for simplified treatment. The rules are also silent on whether simple cases shall be reviewed within a shorter timeframe than other cases and there is no commitment in the rules to review simple cases on an expedited basis.

The statutory review period for all cases therefore remains that provided for in Articles 25 and 26 of the Antimonopoly Law, i.e. a first-phase review lasting up to 30 days, followed by a possible second-phase review lasting up to 90 days, which itself can be extended in certain circumstances by another 60 days. The total duration of the statutory merger review period can therefore potentially reach 180 days, with no expedited process provided for simple cases.[6] Further, and consistent with the practice of other competition authorities, the first-phase review period will only start running after MOFCOM has verified that the information submitted in the notification form is complete, a process which in China can last several weeks. It is not unusual for MOFCOM to take up to two months to satisfy itself that the notification is complete, leading the possible duration of the whole review process to reach eight months.

Against this background, it is not surprising that companies and their advisers were somewhat apprehensive when the simple cases rules became effective on April 18, 2014. These concerns were, however, misplaced. The vast majority of the transactions that had been approved under the new rules by December 31, 2014 were reviewed within the first phase, with only six out of 69 cases requiring the opening of a second-phase review. And among these six cases, clearance was obtained very early on during the second phase in respect of four transactions, with only two transactions for which the process lasted well into the second phase.[7] As mentioned, the average

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[4] The *Interim Regulation* is *available at* http://fldj.mofcom.gov.cn/article/xgxz/201404/20140400555353.shtml.

[5] The *Guidance Note* is *available at* http://fldj.mofcom.gov.cn/article/xgxz/201404/20140400555353.shtml.

[6] MOFCOM's practice so far has been to interpret these statutory periods as referring to calendar days, with no suspension for holiday periods.

[7] *See* the following cases: http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201406/20140600629211.shtml (public notice issued on 18 June 2014 and clearance decision adopted on 22 July 2014);
http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201408/20140800688011.shtml (public notice issued on 6 August 2014 and clearance decision adopted on 5 September 2014);
http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201408/20140800705650.shtml (public notice issued on 22 August 2014 and clearance decision adopted on 28 September 2014);
http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201409/20140900730611.shtml (public notice issued on 15 September 2014 and clearance decision adopted on 15 December 2014);

duration of the review procedure was of 27 days for those transactions that had been approved by year-end.

The above information is derived from the public announcements made by MOFCOM in respect of each transaction it provisionally accepts as eligible for simplified treatment, and on the list of unconditional approvals made public by MOFCOM on a quarterly basis. There is no publicly available information concerning the average duration of MOFCOM's initial review of notifications for completeness. Anecdotal evidence based on our practice, however, indicates that if there are any delays at that initial stage, these are due to genuine questions raised by MOFCOM officials when performing their review. This is the case despite the uncertainties that remain concerning the application of the eligibility criteria, which are discussed further below.

Another aspect of the procedure that is left unaffected by the new rules is the level of MOFCOM's scrutiny over transactions that qualify as simple cases. The more limited disclosure requirements in the *ad hoc* notification form which should be used in relation to simple cases[8] suggest that MOFCOM is prepared to subject qualifying transactions to a lesser degree of scrutiny, but neither the *Interim Regulation* nor the *Guidance Note* formally provide for a simplified assessment. The assessment criteria remain those provided at Article 27 of the Antimonopoly law, and MOFCOM retains its ability to make use of its investigation powers under the law.[9]

There are no publicly available documents or guidance from MOFCOM about the way it conducts its assessment of simple cases but, so far in our experience, the authority has paid particular attention to comments received from interested stakeholders during the public consultation process. Nothing suggests a significantly more relaxed assessment, although the reliance on a public consultation process indicates that MOFCOM will generally be more reactive than proactive in its review of simple cases.

III. ELIGIBILITY CRITERIA

The *Interim Regulation* sets out the criteria pursuant to which transactions that are subject to merger control clearance under Article 20 of the Antimonopoly Law will qualify as simple cases. The six criteria are set out in Article 2 of the *Interim Regulation*:

1. where the undertakings participating in the concentration are active in the same market, their combined market share on the overlap market is below 15 percent;

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http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201410/20141000759200.shtml (public notice issued on 14 October 2014 and clearance decision adopted on 19 November 2014);
http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201410/20141000761872.shtml (public notice issued on 16 October 2014 and clearance decision adopted on 10 December 2014); and
http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201411/20141100813685.shtml (public notice issued on 28 November 2014 and clearance decision adopted on 31 December 2014).

[8] *See* Article 4 and Annex 1 to the *Guidance Note*.

[9] *See* mainly MOFCOM's Interim Regulation on the Assessment of the Competitive Effects of Concentrations of Undertakings of 29 August 2011, MOFCOM's Measures on the Review of Notified Concentrations of Undertakings of 21 November 2009, and MOFCOM's Guidelines on Procedures for Merger Review of 3 March 2010.

2. where the undertakings participating in the concentration are in a vertical relationship, their respective market share in the relevant upstream and downstream markets is below 25 percent;
3. where the undertakings participating in the concentration are neither in the same market nor in a upstream-downstream relationship, their respective market share in the relevant markets on which each is active is below 25 percent;
4. where a joint venture is being established outside China, the joint venture does not engage in any business activities in China;
5. where the equity or assets of a foreign enterprise are being acquired, that foreign enterprise does not engage in any business activities in China; and
6. where a joint venture jointly controlled by at least two undertakings becomes controlled by one or more of them after the concentration.

Article 3 of the *Interim Regulation* provides for certain exceptions where the above criteria will not apply (for example when relevant markets cannot be easily identified), and MOFCOM retains the discretion to disapply these criteria in particular cases.

Considered independently, the eligibility criteria are straightforward to understand. The six grounds for qualifying as a simple case can be segmented in two groups. The last three relate to clear commercial or legal circumstances; the first three relate to market conditions, measured by way of the parties' market shares.

The market share thresholds referred to in the first three criteria can give rise to some uncertainty, given the varying views that may exist on parties' market positions and the often limited availability of robust market data concerning Chinese markets. However, in practice parties and their advisors will be familiar with the concepts. In our experience, where the market data is lacking or imprecise, parties will know early on that their eligibility under the simplified procedure is uncertain, providing predictability to the process. To our knowledge, the market share-based approach has not led to any significant issues, and the *Interim Regulation* reveals in this respect a pragmatic and practicable approach.

What has, however, given rise to some uncertainty is the interplay between the different criteria. This is because the text of the *Interim Regulation* does not expressly specify that the conditions are alternative or cumulative. This has led to significant ambiguity in the application of the grounds provided in the regulations. While MOFCOM had brought certain clarifications by the end of the year, a number of issues remain unresolved at the time of writing.

There are, first of all, uncertainties regarding the first group, i.e. the three market share-based criteria. Conditions 1 and 2 are independent from one another. It is clear from the text of the Regulation that if (i) the parties to the transaction are active in the same market and (ii) they are also in an upstream-downstream relationship, they must fulfill each of conditions 1 and 2. Judging from the text of the *Interim Regulation,* conditions 1 and 2 are therefore cumulative.

However, the wording of the third criterion ("where the undertakings participating in the concentration are neither in the same market nor in a upstream-downstream relationship") seems to indicate that this condition is subsidiary, in the sense that it must only be considered where conditions 1 and 2 are not met or not relevant. In other words, it appears from the text of the *Interim Regulation* that where parties that are neither in the same market nor in a upstream-

downstream relationship, they need not consider grounds 1 and 2 and should only consider ground 3—i.e., if they have market shares in excess of 25 percent on markets relevant to the transaction, they will not be eligible for the simplified procedure. However, if the same parties have a horizontal competitive relationship with a combined share below 15 percent, they would fulfill ground 1, and they would not need to consider whether they qualify for ground 3—i.e. they would be eligible for the simple cases procedure even if one of them achieves more than 25 percent of all sales on a separate but still relevant market. In sum, conditions 1 and 2 are cumulative, and condition 3 is an alternative when neither of the first two conditions is met or relevant.

The second group of criteria, which relate to commercial or legal circumstances listed in paragraphs 4, 5, and 6 of Article 2, are to a large extent mutually exclusive. It appears directly from their content that they are alternative criteria.[10] This review of their wording leaves however the question open as to whether a transaction eligible under one or more of these last three conditions also needs to fulfill the market share conditions mentioned in the first three paragraphs of this Article. For example, is it sufficient that the target does not engage in any business activities in China, fulfilling criterion 5, or should the parties also fulfill the market share criteria under the first three paragraphs in order to qualify?

It appears from the above analysis of the text of Article 2 of the *Interim Regulation* that the eligibility criteria are very ambiguous. When the new rules became effective in April, MOFCOM sought to remedy the uncertainty to some extent. In the public notice form annexed to the *Guidance Note*, parties must select among the six reasons for which they consider the simplified procedure applies. MOFCOM specified in the form that they "**may** choose more than one option" (emphasis added), confirming that several of the conditions under Article 2 may be fulfilled at the same time.

This was, however, not enough to quell the uncertainty. After a few months, MOFCOM realized that many concerns were left unaddressed. On October 8 it released a new public notice form containing more guidance. First, a revised footnote 1 provides more guidance on the first criteria as follows: "The grounds 1-3 can be selected cumulatively or separately; where no selection is made, the relevant ground(s) will be viewed as not applicable to the transaction."

There is also some guidance concerning the relationship between the two categories of criteria. In relation to the interplay between condition 1 (a combined market share below 15 percent if parties are both active on the same market) and condition 6 (where a joint venture jointly controlled by at least two undertakings becomes controlled by one or more of them after the concentration), footnote 3 explains as follows:

> [f]or joint ventures that are jointly controlled by two or more parties and, via the concentration become controlled by one of the parties, if such party and the joint venture are competitors belonging to the same relevant market, the notifying

[10] A review of the public notices issued as at 31 December 2014 shows however that MOFCOM has accepted that parties rely on two of these three criteria in two cases. *See* http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201409/20140900718481.shtml and http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/201411/20141100800680.shtml.

party must select grounds 1 and 6 as reasons for applying for the simple cases procedure.

The issuance of a revised public form in October did bring some degree of clarification, but many questions remain unresolved. A review of the public notice forms published after October shows a marked increase in the number of parties that chose one of the conditions in the second group (mainly those related to commercial circumstances, such as the lack of nexus between the target and China) without referring to the market-share thresholds being met. Still, there remain many public notice forms where parties consider that they fulfill a series of the market share grounds (1 to 3) as well as the legal or commercial grounds (4 to 6).

As the year came to an end, the eligibility criteria were still not entirely clear. Still, market share-related conditions are the grounds selected by the parties in a majority of cases, and we are not aware—based on our (limited) experience—of cases where the vagueness of the qualifying conditions have led to significant discussions or delays with MOFCOM officials.

IV. SIMPLIFIED NOTIFICATION FORMALITIES

The *ad hoc* notification form which should be used in relation to simple cases requires fewer disclosures from the notifying parties and a more succinct competition analysis. Of particular note is the possibility for foreign parties to re-use notarized and authenticated materials that had been submitted as part of a previous filing made within the last two years. These simplification measures have brought clear benefits and have, to our knowledge, not given rise to particular interpretation difficulties.

V. CONCLUSION

With the advent of an effective simplified merger control procedure, the Year of the Horse brought significant procedural improvements to China's antitrust screening process of concentrations. This should free up resources to devote more attention to the substantive assessment of more difficult cases in the years ahead.

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Merger Filing Regime in China: Uncertainty Still Remains in the Concept of "Control"—Complex Dilemma Faced by Foreign Investors

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Merger Filing Regime in China: Uncertainty Still Remains in the Concept of "Control"—Complex Dilemma Faced by Foreign Investors

Kiyoko Yagami[1]

I. INTRODUCTION

In June 2014, the Chinese Ministry of Commerce ("MOFCOM") issued *Guiding Opinions on the Notification of Concentration between Business Operators* ("2014 Guiding Opinions"), which provides further clarifications on various important areas of the merger control regime in China, including the concept of "control." The acquisition of "control" is a key threshold for determining whether a given business transaction needs to be notified to MOFCOM. However, the new 2014 Guiding Opinions remain silent on what kind of minority acquisitions will qualify as "concentrations" under the Anti-Monopoly Law ("AML").

This article will briefly introduce the legislative history and precedent cases concerning merger control under the AML, in particular with respect to minority acquisitions, and will also touch upon practices in Japan and other East Asian jurisdictions in an attempt to predict MOFCOM's possible supervisory approach.

II. MOFCOM'S ACTIVE ENFORCEMENT CONTINUES

MOFCOM continued to actively enforce merger-filing regulations in 2014. By the end of August 2014, MOFCOM had reviewed 875 merger notification cases since the AML came into force in 2008, 849 of which were cleared without any condition and 24 of which were cleared with conditions.[2] Interestingly, among those cases that were reported to be cleared without condition, the majority (which accounts for 53 percent of all non-conditional cases) relate to foreign-to-foreign transactions, while 36 percent relate to Sino-foreign transactions, and pure domestic transactions account only for 11 percent.[3]

There were two cases that were blocked by MOFCOM. One case was Coca-Cola's attempted acquisition in 2009 of Huiyuan, a China-based fruit juice producer listed in Hong Kong.[4] Another case concerned three of the largest container shipping lines in the world, namely: Denmark's AP Møller-Maersk A/S, Switzerland's Mediterranean Shipping Company, and

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[2] http://www.yicai.com/news/2014/09/4018015.html.

[3] This is based on our internal analysis on the non-conditional decisions reported by MOFCOM during the period from August 2008 through December 2014. It should also be noted that approximately 30 percent of these non-conditional decisions concern Japanese companies.

[4] MOFCOM's decision of March 18, 2009 is *available at* (in Chinese): http://fldj.mofcom.gov.cn/article/ztxx/200903/20090306108494.shtml.

France's CMA CGM, who wished to form a long-term shipping alliance called "P3."[5] Notably, MOFCOM's decision in the *P3 Shipping Alliance* case in 2014 to block the proposed transaction was in contrast to the green light given in other jurisdictions including the United States and the European Union. This indicates MOFCOM's confidence and willingness to choose its own path even if that path diverges from the position taken by other leading competition authorities.

Although MOFCOM has accumulated a great deal of experience in reviewing notified cases during the past six years, due to a mounting caseload and lack of resources within MOFCOM, review periods continue to be lengthy. The majority of notified cases still go into phase 2 of the procedure, regardless of the level of competitive concerns that arise from the transaction. The "pull-and-refile" practice, whereby already-filed notifications are withdrawn and refiled in order to "reset" the review period (mainly to avoid a decision to prohibit the transaction or a conditional decision from MOFCOM), is now not uncommon in China (e.g., the *Western Digital/Hitachi Storage* case in 2012, the *Glencore/Xstrata* case in 2013, and the *Marubeni/Gavilon* case in 2013).

III. INTERPRETATION OF "CONTROL" UNDER THE AML

A. Meaning of "Control" Under the AML and Its Implementing Regulations

Under Article 20 of the AML, notifiable concentrations include: (i) mergers, (ii) acquisitions of control by means of asset or equity purchases, and (iii) acquisitions of control or decisive influence through contract or any other means. From this legislation it is apparent that the AML uses an "acquisition of control" test to identify those transactions that are subject to merger control scrutiny. The key questions are, therefore: What is the meaning of "control" in the AML, and How should the concept be applied in practice? Until recently, neither the legislation nor MOFCOM had provided any formal guidance on the interpretation of "acquisition of control" or "decisive influence."

In its draft *Measures on the Notification of Concentrations between Business Operators* ("Draft Notification Measures"), released by MOFCOM for public comments in March 2009, "control" was defined as:

> the ability to decide on the appointment of one or more members of the board of directors and the core management personnel, the financial budget, sales and operations, pricing, major investments and other important management and operational decisions etc. in relation to another business operator by means of acquiring shares or assets of the business operator, as well as by contractual or other means.

It was also recognized in the same Draft Notification Measures that veto rights granted to minority shareholders for the purpose of protecting the interests of such shareholders with respect to amendment of the articles of association, capital increases and decreases, and liquidations would not be deemed as obtaining control. Unfortunately, these provisions were dropped from the *Measures on the Notification of Concentrations between Business Operators*

[5] MOFCOM's decision of June 17, 2014 is *available at* (in Chinese): http://fldj.mofcom.gov.cn/article/ztxx/201406/20140600628586.shtml.

issued by MOFCOM in November 2009, but they were often referred to by practitioners as "hints" that could be used to apply the "acquisition of control" test to minority investments.

B. Implications from Precedent Decisions—The Panasonic/Sanyo Case and the Alpha V/Savio Case

There are few published precedents to provide further guidance on the notification requirement for minority acquisition cases.

MOFCOM's conditional decision on the proposed acquisition of Sanyo by Panasonic in 2009 can be viewed as one such precedent.[6] After a time-consuming review, MOFCOM found possible anticompetitive effects in three market segments for different types of batteries that would be highly concentrated after the transaction. To remedy such effects, MOFCOM required the parties to divest significant portions of their businesses related to the three relevant markets. In addition, MOFCOM required Panasonic, which had invested in a joint venture with Toyota in one of the relevant markets, essentially to: (i) reduce its ownership in the joint venture from 40 percent to 19.5 percent, (ii) waive its right to appoint directors to the joint venture company's board, and (iii) abandon its veto rights at shareholder meetings for resolutions concerning the battery business.

The decision in the *Panasonic/Sanyo* case does not specifically mention how Panasonic, in MOFCOM's opinion, would be able to gain a competitive influence through its minority shareholding in the joint venture. However, given MOFCOM's proposed remedies, it appears that a shareholding below 20 percent, the right to appoint directors to the board, and a veto right for business decisions may be the key elements for gauging the competitive influence of a minority shareholder.

Another conditional approval decision on the acquisition by Alpha Private Equity Fund V ("Alpha V") of Savio Macchine Tessili S.p.A ("Savio") in 2011 also provides some guidance on how MOFCOM analyzes the concept of minority shareholder control. According to MOFCOM's announcement,[7] Alpha V held a 27.9 percent interest in Uster Technologies A.G. ("Uster") and was its largest shareholder. Savio (through its 100 percent subsidiary) was the only competitor of Uster in the electronic yarn clearer market.

MOFCOM reportedly looked specifically into voting patterns at shareholders' meetings as well as the composition and voting pattern of Uster's board of directors. In the end, MOFCOM concluded that the possibility that Alpha V would influence Uster's business operations and that Alpha V could coordinate the operations of Savio and Uster could not be excluded. MOFCOM thus reached an approval decision with the condition that Alpha V should divest its 27.9 percent interest in Uster to a third party.

The *Alpha V/Savio* case is one of the few cases in which MOFCOM addressed the potential influence of a minority shareholder in a public decision. However, the case neither

[6] MOFCOM's decision of October 30, 2009 is *available at* (in Chinese): http://fldj.mofcom.gov.cn/article/ztxx/200910/20091006593175.shtml.

[7] MOFCOM's decision of November 7, 2011 is *available at* (in Chinese): http://fldj.mofcom.gov.cn/aarticle/zcfb/201111/20111107809156.html.

elaborates how Uster and Savio could coordinate merely through having a common shareholder (Alpha V), nor provides any guidance on how minority shareholders could "control" or have a "decisive influence" over another company.

The specific factors that MOFCOM announced that it had used in its analysis at least suggest that the influence of minority shareholdings may be analyzed based on the elements provided for in the Draft Notification Measures. The *Alpha V/Savio* decision is particularly notable for private equity groups, trading houses, and other foreign conglomerates that hold minority interests in a large number of companies.

C. Unconditional Decisions on Foreign-To-Foreign Minority Investments

Given the uncertainty as to MOFCOM's enforcement of the merger control regime, if a minority investor intends to be proactively involved in the management or business operations of the target entity either by holding special voting rights (beyond mere minority protection rights) or dispatching one or more employees to the board of directors, such investor should consider filing a notification even where the investment occurs outside China.

Looking at the recent list of unconditional decisions that MOFCOM publicly announced through its website, we can see that a number of foreign-to-foreign minority acquisitions have been notified to MOFCOM. One example is an acquisition of a minority stake in Scholz AG (a German scrap recycler) by Toyota Tsusho Corporation, in which Toyota Tsusho agreed to acquire 39.9 percent of the shares of Scholz AG from its existing shareholders and to dispatch its employees to the board of directors of Scholz AG upon completion of the acquisition.[8] Another example is ON Semiconductor's agreement with Fujitsu Semiconductor to acquire 10 percent of the shares of a newly established subsidiary of Fujitsu Semiconductor in Japan.[9]

Needless to say, there are more such examples on the list of simplified notification cases published by MOFCOM for public consultation.[10] Looking at these trends, it can be said that both MOFCOM's active enforcement of the AML and its broad notion of "control" are gaining global recognition from companies operating in foreign markets.

IV. NEW GUIDANCE ON THE CONCEPT OF "CONTROL"

As introduced in I. above, the new 2014 Guiding Opinions replace the previous guidance issued on January 5, 2009. They basically provide further clarification on four important areas of merger control filing, including: (i) the concept of "control" (Article 3); (ii) types of joint ventures which qualify as concentrations (Article 4); (iii) the calculation of turnover used for

[8] List of the cases cleared by MOFCOM without any condition during the third quarter of 2014 (October 11, 2014): http://fldj.mofcom.gov.cn/article/zcfb/201410/20141000755915.shtml. Press release by Toyota Tsusho Corporation (April 10, 2014): http://www.toyota-tsusho.com/english/press/detail/140410_002614.html.

[9] List of the cases cleared by MOFCOM without any condition during the fourth quarter of 2014 (January 7, 2015): http://fldj.mofcom.gov.cn/article/zcfb/201501/20150100859173.shtml. Press release by Fujitsu Semiconductor (July 31, 2014): http://jp.fujitsu.com/group/fsl/en/release/20140731.html.

[10] Details of the transactions notified through the simplified procedures are posted on MOFCOM's website (*available at:* http://fldj.mofcom.gov.cn/article/jyzjzjyajgs/) for mandatory public consultation, as per Article 7 of the *Guiding Opinions on the Notification of Simple Cases of Concentrations between Business Operators*, issued on April 18, 2014.

assessing the notification requirement (Articles 5-8); and (iv) detailed procedures for pre-notification consultations (Articles 9-12).

Among other things, the 2014 Guiding Opinions are notable as it is the first time MOFCOM has offered formal guidance on the meaning of "control." Article 3 first acknowledges that there are different types of "control," including sole control and joint control, although the definitions of these different types of control are not provided. It further states that an agreement regarding the concentration and the articles of association of the target entity should be regarded as primary references in assessing whether there is an acquisition of control or decisive influence.

Other factors that should be considered in such an assessment include the following:

- the purpose of the transaction and future projections;
- the target's shareholding structure before and after the transaction and any relevant changes;
- matters subject to a vote in shareholders' meetings and voting mechanisms, as well as attendance records and voting results in the past;
- the composition of the board of directors and board of supervisors of the target entity and their respective voting mechanisms;
- appointment and removal of the target's senior management;
- whether there are any arrangements concerning the exercise of voting rights or any persons acting in concert among the shareholders, among the directors, or between the shareholders and the directors of the target entity; and
- whether there are any major business relationships or cooperation agreements between the undertaking and the target entity.

However, the 2014 Guiding Opinions do not further stipulate any circumstances under which "control" will likely be found. Unlike the Draft Notification Measures, the 2014 Guiding Opinions remain silent as to the type of minority acquisitions that should qualify as "concentrations" under the AML.

In particular, the much debated question of whether minority shareholder protection mechanisms (such as statutory veto rights) can lead to an acquisition of control remains unanswered. Due to the complex nature of this issue, MOFCOM probably wanted to maintain flexibility and discretion in handling these types of cases by dealing with them on a case-by-case basis. On the other hand, as the 2014 Guiding Opinions' explanation of the meaning of control is somehow different from that previously provided in the early draft in 2009, the assessment of the minority shareholding issue has become even more complex.

V. FORMALISTIC APPROACH IN EAST ASIAN JURISDICTIONS

The merger control regimes adopted in East Asian jurisdictions rely on a more straightforward and formalistic approach than China or the European Union to filter the concentrations that fall within the scope of merger control. In these jurisdictions, minority share acquisitions exceeding certain equity thresholds qualify as "concentrations" irrespective of

whether control is acquired.[11] Under the Anti-Monopoly Act of Japan, share acquisitions resulting in the acquirer holding more than 20 percent of the total voting rights in the target entity will qualify as a notifiable concentration.[12] Similarly in South Korea, share acquisitions resulting in the acquirer holding more than 20 percent (15 percent for a listed Korean entity) of the voting shares in the target entity will qualify as a concentration.[13] In Taiwan, share acquisitions resulting in the acquirer holding more than one-third of the voting rights or capital in the target entity will qualify as a concentration.[14]

Such formalistic merger control regimes are usually welcomed by business sectors as straightforward approaches that can provide legal certainty and predictability to market participants. However, in practice, they sometimes filter a different range of transactions than those under a "change of control" test regime. In particular, under the Japanese merger control regime in which an acquisition of a minority ownership of over 20 percent of voting rights will be caught, an acquisition that increases a shareholding from 19 percent to 21 percent will be subject to a filing requirement even if there is no acquisition of control, while an acquisition that increases a shareholding from 21 percent to 49 percent—though potentially implicating an acquisition of "control"—will not trigger a merger filing requirement.

VI. JFTC'S APPROACH IN FINDING A "JOINT RELATIONSHIP"

The analysis of control still plays a role at the substantive review stage in those jurisdictions that have adopted quantitative approaches to identify the cases subject to merger review. In the substantive review conducted by the Japan Fair Trade Commission ("JFTC"), any entities that are in a close relationship with an acquirer or a target may be deemed to be in a "joint relationship," whereby these entities could be treated as an integrated group for the purpose of the substantive analysis.[15]

According to the JFTC Merger Guidelines,[16] a joint relationship, similar to the "acquisition of control" test, will be assessed on a case-by-case basis, using various factors. These factors include the shareholding structure; the relationship between the shareholders; any interlocking directorates; any other commercial, financial, or business relationships; and/or technology licensing between the parties. The JFTC Merger Guidelines do not stop here; they further offer some specific illustrations on how these factors can be assessed in different types of concentrations, such as:

- In the context of share acquisitions, (i) a minority shareholding of over 20 percent and the absence of other shareholders with the same or higher shareholding ratios would suffice to find a joint relationship, while (ii) such relationship would not be established

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[11] Detailed country-by-country analysis can be found in Maxime Vanhollebeke & Shan Hu, *Minority Participations and Merger Control Filing Requirements in East Asia*, CPI ASIA J. (November 5, 2014), *available at:* https://www.competitionpolicyinternational.com/assets/Uploads/AsiaNovember14.pdf.

[12] Article 16, ¶3 of the Implementation Rules of the Anti-Monopoly Act of Japan.

[13] Article 12 of the Monopoly Regulation and Fair Trade Act of Korea.

[14] Article 6 of the Fair Trade Act of Taiwan.

[15] Part I, Section 1 (1) of the JFTC Merger Guidelines.

[16] English translation of the JFTC Merger Guidelines is *available at:*: http://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/110713.2.pdf.

where the acquirer's shareholding is 10 percent or less, or where the acquirer is not ranked among the top three shareholders in terms of shareholding size.[17]

- In the context of interlocking directorates, a joint relationship would be formed where (i) the officers or employees of one company comprise a majority of the total number of officers of another company, or (ii) the representative director of one company holds the authority to represent another company at the same time.[18]

A typical example in which the JFTC assessed the formation of a joint relationship between two parties was the proposed merger between Nippon Steel Corporation ("NSC") and Sumitomo Metal Industries in 2011.[19] In part of its review, the JFTC found a joint relationship between NSC and Godo Steel (in which NSC holds 15.7 percent of the shares) by finding that (i) NSC is the largest shareholder of Godo Steel, holding more than 10 percent of the voting rights; (ii) employees of NSC hold officer roles at Godo Steel; and (iii) there are business alliances between NSC and Godo Steel, including the manufacturing consignment of products. However, in the JFTC's view, such relationship between NSC and Godo Steel is "not strong enough to be totally integrated," and the JFTC concluded that "a certain level of competition is likely to be maintained" between the merged company and Godo Steel after the merger.[20]

The application of the merger regulations may vary from case to case, but the guidance in the JFTC Merger Guidelines, together with the case-by-case analysis contained in precedent cases, provide clarity to the JFTC's enforcement of the merger regulations. Although MOFCOM's approach to identifying notifiable concentrations is different from that in Japan or other East Asian jurisdictions, MOFCOM may consider borrowing experience from the substantive review process of these jurisdictions in order to refine its own review process, in particular the application of the "acquisition of control" test.

VII. CONCLUSIONS

In December 2014, MOFCOM for the first time publicly announced its imposition of a fine on Tsinghua Unigroup which failed to notify its acquisition of RDA Microelectronics in accordance with the AML.[21] Given MOFCOM's more assertive enforcement of the merger control regime, foreign investors with a business presence in China may face a catch-22 situation when entering into a minority acquisition: Engage in a lengthy merger review procedure even though its investment will be limited to a minority stake, or take the risk of incurring fines and reputational damage for failing to file a notification to MOFCOM. The uncertainty that lies in the interpretation of "acquisition of control" or "decisive influence" under the AML is making the situation even more complex for those investors.

In order to promote legal certainty for the business community, MOFCOM's application of the "acquisition of control" test to minority investment cases requires greater clarity, either by

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[17] Part I, Section 1 (1) of the JFTC Merger Guidelines.

[18] Part I, Section 2 (2) of the JFTC Merger Guidelines.

[19] JFTC's decision of December 14, 2011 is *available at* (in English): http://www.jftc.go.jp/en/pressreleases/yearly-2011/dec/individual-000457.files/2011_Dec_14.pdf.

[20] Pp. 35-36 of the JFTC decision (footnote 19).

[21] MOFCOM's Administrative Penalty Determination Letter published on December 8, 2014.

issuance of additional formal guidelines or publication of landmark cases concerning minority acquisitions. As long as uncertainty remains, foreign investors whose group turnovers exceed the thresholds have no other choice but to consider filing a notification under the AML.

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China's Recent Antitrust Investigations and Lessons for Foreign Companies

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China's Recent Antitrust Investigations and Lessons for Foreign Companies

YANG Liu[1]

I. INTRODUCTION

The Anti-Monopoly Law ("AML"), in force since August 1, 2008, is often considered the "economic constitution," safeguarding fair competition and China's sound market economy.[2] The AML established an administrative and judicial framework that is conceptually similar to that of other jurisdictions' competition law systems. Since its entry into force, the AML has been used to prevent undue concentrations of market power, combat cartels and abuse of market dominance, and pursue other goals that enhance the overall competitive environment in China. However, China's recent antitrust investigations have triggered widespread backlash among western business circles by involving some world-famous multi-national companies ("MNCs"), including Microsoft, Qualcomm, BMW, etc. Some have accused China of using the AML as a weapon to target foreign companies, while others have condemned the AML for the lack of clarity in its provisions and transparency and certainty in enforcement.[3]

To better interpret the AML and the trends in its enforcement, MNCs that have business operations in China should acquire better knowledge on China's unique socialist market economy and take into consideration procedural issues as to antitrust enforcement in China.

II. THE AML AND THE SOCIALIST MARKET ECONOMY

Antitrust law has long been an international practice. Compared with other Chinese laws, the AML enjoys more common characteristics and principles with international norms. Meanwhile, a number of features in the AML differ in small or large ways from typical competition laws in other countries, in particular those shaped by the important socialist heritage of China's market economy.

As the world's second largest economy, China distinguishes itself from other major world economic powers by featuring its Chinese socialist characteristics, the so-called "socialist market economy with Chinese characteristics." As a mixed economic system, it has confused the international business community by presenting the features of both a socialist planned economy and the market economy.

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[2] Xiaoye Wang, *The Reform of Economic System and Anti-Monopoly Law In China*, 79(3) ORIENTAL L. (2009).

[3] Xinhua News, *The bulletin of the third of the 18th congress of the Chinese Communist Party* (Nov.12, 2013), http://news.xinhuanet.com/politics/2013-11/12/c_118113455.htm.

The socialist market economy embodies the common features of market economy. In a market economy, it is the market that plays *the overarching role in allocating recourses,*[2] encouraging competition and stimulating productivity. China hailed the socialist market economy as the fundamental national economic system and would spare no effort to make it more efficient, fair, and sustainable in the years to come. On the other hand, China's market economy is shaped by the political system. As a socialist country, China has put public ownership in the dominant position, though ownerships of other kinds are allowed to coexist.

Mirroring these features of China's economic system, the purposes of the AML are to prevent and prohibit monopolistic conduct, to protect fair market competition, to promote economic efficiency, to safeguard the interests of consumers, and to promote the healthy development of the socialist market economy (see Article 1 of the AML). Article 4 further provides that "the State shall establish and implement competition rules appropriate for the socialist market economy, shall improve macroeconomic regulation and control, and shall establish a unified, open, competitive and well-ordered market system."

Although with the progress of the economic reforms in China a dynamic private sector has emerged in many parts of the economy, a number of key sectors remain dominated by state-owned enterprises ("SOEs"), and administrative authorities are still extensively involved in regulating competition in a number of industries, e.g. telecommunications, electricity, tobacco, etc. The AML makes reference to these government-administered industries, but the extent to which the AML will be fully applied to them is uncertain. Article 7 provides that:

> the State shall protect the lawful operations of the business operators in industries vital to the national economy and national security and controlled by the state-owned economy, as well as in industries subject to exclusive operations and sales according to the law, and shall supervise, adjust and control the operations of such business operators and the prices of their products or services, in order to protect the interests of consumers and promote technological progress.

This provision blurs the lines of oversight, although it clearly stipulates that SOEs are not fully immune to the law. Indeed, the second paragraph of Article 7 prohibits SOEs from abusing their dominant positions or legal monopolies to the detriment of consumers.

The ambiguity in the AML as to the treatment of SOEs increases the discretion of the enforcement agencies, which may have close connections with some SOEs. As a result, some observers have expressed concern that the SOE-dominated sectors will be subject to more lenient treatment under the AML compared to those sectors in which foreign enterprises play a more important role.[4]

The enforcement practices appear to indicate so. In recent years, especially in 2014, China's antitrust enforcement has come into the limelight. From the biggest fine ever issued since the enactment of the AML to the largest number of enforcement lists being made; from the automobile and auto spare parts industry to smartphone industry; from well-known domestic firms to MNCs, the world has witnessed all these achievements in China's antitrust enforcement.

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[4] South Weekend, *Five years for Chinese anti-monopoly: how to handle the strong state-owned enterprises is the biggest challenge* (Sep.27, 2013), http://www.infzm.com/content/94649.

However, along with achievements comes criticism. The Chinese antitrust authorities have been criticized for being selective in the companies they have investigated, since many of them involved MNCs. Some media claim that China's efforts have been aimed not so much to strengthen the AML but to increase its leverage on bilateral trade negotiations; others even concluded that foreign companies have been targeted in the recent round of the AML investigations in China.[5]

As a response, the Chinese Premier Li Keqiang provided clarification during the 2014 Summer Davos meetings: "only 10% of the enterprises involved in the antitrust investigations are foreign ones, which clearly indicates that the AML did not and will not target specific kinds of business entities."[6] Some experts agreed.[7]

The situation may result more from coincidence rather than intent when many MNCs are involved in recent antitrust investigations. As the Chinese antitrust authorities are still in the process of fully establishing themselves as well-recognized enforcers, they may be inclined to investigate industries that have a major impact on everyday lives of consumers. In some of these sectors, many of the big players are foreign companies.[4]

As to the reason of the perceived sudden increase of enforcement against foreign companies, instead of taking the phenomenon as selective or discriminatory in nature, it may be more reasonable to interpret it as a sign of the enforcers' growing confidence. After a few years of accumulating enforcement experience from investigations of small domestic companies and internal training of their staff, the Chinese antitrust authorities are now becoming more confident in launching investigations against foreign companies.[5] However, comparatively, the confidence and strong position have been less reflected in the regulators' enforcement against SOEs, although Chinese officials have given extensive assurances to the effect that the AML is not aimed at foreign companies.

From a judicial perspective, the *Opinions on Protecting Privately-owned Businesses and Ensuring their Sound Development*, the latest guideline issued by China's Supreme People's Court, once again makes it clear that the legitimate rights of foreign companies are equally protected and their business operations are free from interference from administrative powers, on the condition that they conduct their business in compliance with the law. This is also in response to *Opinions of the State Council on Promoting Fair Market Competition and Maintaining the Normal Market Order*, which upholds the idea of promoting an open market

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[5] Global News, *The European Chamber criticized that foreign enterprises have been targeted in the recent round of the AML investigations in China* (Aug.15, 2014), http://finance.huanqiu.com/view/2014-08/5106840.html and China News, *there are only 33 foreign undertakings in the total 339 institutions investigated by NDRC* (Dec.7, 2014), http://www.chinanews.com/gn/2014/12-07/6852345.shtml.

[6] Ifeng News, *Li Keqiang: "only 10% of the enterprises involved in the anti-monopoly investigations are foreign ones*" (Sep.9, 2014), http://finance.ifeng.com/a/20140909/13084535_0.shtml.

[7] China Daily News, *If the antitrust enforcement in China scares off foreign enterprises?* (Oct.21, 2014), http://www.chinadaily.com.cn/hqcj/gjcj/2014-10-21/content_12561068.html; Competition Law News, *Experts clear the suspects of antitrust enforcement: the foreign undertakings are not targeted* (Aug.11, 2014), http://www.competitionlaw.cn/info/1041/21627.htm; and Sohu News, *Experts claim that the foreign and domestic undertakings will be treated equally in the antitrust enforcement* (Sep.4, 2014), http://news.sohu.com/20140904/n404042156.shtml.

environment with more transparency and fair competition. As for the antitrust enforcement, it will be interesting to see how antitrust investigations launched against Chinese and foreign companies will resemble each other in the future.

III. CHALLENGES AND ACHIEVEMENTS IN RELATION TO DUE PROCESS AND TRANSPARENCY

Recent antitrust investigations into MNCs have raised concerns in relation to due process during investigations. For example, in the investigations against foreign companies in industries such as soaps and detergents, infant formula, and automobiles, due process shortcomings were reported by lawyers on the ground, chambers of commerce, and the press. It was also reported that NDRC has repeatedly resorted to heavy-handed tactics to enforce the AML, such as threatening higher penalties for companies that seek to offer arguments in their defense and demanding changes in company pricing and other behavior before the investigation has concluded.

For example, the European Union Chamber of Commerce in China released a statement, expressing concern over China's antitrust investigations. It said:

> [t]he European Chamber has received numerous alarming anecdotal accounts from a number of sectors that administrative intimidation tactics are being used to impel companies to accept punishments and remedies without full hearings. Practices such as informing companies not to challenge the investigations, bring lawyers to hearings or involve their respective governments or chambers of commerce are contrary to best practices.[8]

In addition, there were complaints about perceived lack of transparency on the part of some antitrust authorities in China, as the public decisions or press releases rarely contain detailed explanations on the rationale of the investigations, penalties, or other determinations in the context of the antitrust enforcement.

Perhaps as a reaction to these complaints and statements, China—through the Chinese Vice Premier Wang Yang—made various historic commitments during the recent meeting at the U.S.-China bilateral forum, the Joint Commission for Commerce and Trade ("JCCT"). China reaffirmed the principles underlying its antitrust enforcement to include fairness, transparency, objectiveness, and non-discrimination and further reassured that companies under investigation should be well informed and ensured with due process to present evidence and defend themselves during antitrust investigations. More specifically, the antitrust administrative actions should strictly follow statutory procedures and requirements laid out in law. To ensure transparency, all administrative decisions under the AML will be provided in writing in a timely manner, subject to considerations of protection of commercial secrets.

China's JCCT commitments complement Chinese procedural law in this era. The procedures of the antitrust investigations are mainly governed by the Administrative Penalties

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[8] The European Chamber News, *The European Chamber releases a statement on China AML-related investigations* (Aug.13, 2014), http://www.europeanchamber.com.cn/en/press-releases/2132/european_chamber_releases_statement_on_china_aml_related_investigations.

Law,[9] the Administrative Reconsideration Law,[10] the Administrative Litigation Law,[11] and judicial interpretations issued by the Supreme People's Court. Under these laws, before imposing certain penalties, an antitrust authority should inform the party of its right to a hearing. If the party requests a hearing, then the hearing should be conducted, and the antitrust authority will decide whether to impose the penalties based on the result of the hearing. If the authority imposes a penalty, the party may apply for an administrative review to the hierarchically higher or other designated administrative authority. If the authority sustains or changes (but does not withdraw) the decision, then the party may initiate an administrative action before a court against the original administrative authority (when the decision is affirmed) or the higher or designated authority (when the decision is changed but not withdrawn). Alternatively, the party may directly file an administrative lawsuit against the antitrust authority.

In practice, however, when an antitrust authority makes a penalty decision in an antitrust investigation, it will be difficult to overrule the decision. Well-established administrative procedures allow review bodies or courts to check on the exercise of discretion. However, in Chinese administrative laws, there are no clear principles of fairness, natural justice, or due process. This makes it very difficult for a review body or court to check on the exercise of discretion. Hence if the discretionary decision of an antitrust authority is unreasonable, there may be no adequate procedural safeguards used to overrule the decision.

Further, although the Administrative Litigation Law provides that an administrative decision—for example, a penalty decision issued by NDRC—should be quashed if statutory procedures have not been followed, in practice courts very rarely overrule the decision of an administrative body on the basis that the act was executed illegally for procedural reasons. This may be because the courts focus mainly on the substantive aspects of the administrative act.

Hence, given that the Chinese government will be keen to honor the commitments made in the JCCT, a proactive defense prior to the adoption of a penalty decision by the antitrust authorities may be the best course of action for a company subject to an antitrust investigation. In other words, it is normally better to influence the preparing of an administrative decision rather than trying to petition the relevant appeal authority in an attempt to overturn a decision already adopted.

Another point worth mentioning is that, apart from Chinese practicing lawyers allowed to attend meetings with antitrust authorities, counsel from foreign law firm representative offices established in China are also permitted to be present during investigations and advise on international law and practice. According to China's JCCT commitments, even foreign legal counsel practicing in other jurisdictions can provide their opinions based on their expertise in a Chinese antitrust procedure. MNCs should take advantage of this, since they usually work closely with their lawyers from international law firms or their home countries.

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[9] Administrative Penalties Law of the People's Republic of China, [1996] Presidential Order No.63, Mar. 17, 1996.

[10] Administrative Reconsideration Law of the People's Republic of China, [1999] Presidential Order No. 16, Apr. 29, 1999.

[11] Administrative Litigation Law of the People's Republic of China, [2014] Presidential Order, No.15, November.1, 2014.

IV. PROACTIVE MEASURES TO MINIMIZE ANTITRUST RISKS

Since most MNCs have been subject to antitrust compliance and enforcement in other countries years before China's AML came into force, they should have sound compliance guidance to ensure their businesses' compliance with Chinese antitrust rules. However, to deal with the current situations in China, MNCs need to take their AML obligations seriously by reviewing their antitrust guidance and auditing their practices to ensure they are able to be compliant with the law to the fullest extent.

In addition, they should bear in mind that China's antitrust regime has unique characteristics. When it comes to the application of the AML, it would be unwise for foreign companies to only stick to their home antitrust laws and ignore Chinese practices and background. In this regard, experienced local lawyers and counsel, with practical experience in China, should play an indispensable role in advising MNCs on dealing with AML-related investigations.

From this point of view, providing local compliance training to employees is considered a precautionary measure aimed at reducing or eliminating any local AML violations. Given the fact that local MNC branches or offices are geographically and culturally far from their headquarters, it is necessary to provide local employees compliance trainings tailored to local needs, making sure they are vigilant on all aspects of their company's operations and keeping an eye on local compliance standards.

In order to better anticipate the AML risks in China, MNCs also need to closely follow development of the most recent AML implementing legislation and enforcement updates. Recent investigations and high-profile fines have already sent a strong signal to incentivize companies to do that.

V. CONCLUSION

Recently, China's Premier Li Keqiang said that "China intends to attract more foreign investments and products by means of providing a fair competitive environment for foreign firms," and that "foreign companies are still very welcome in China."[12] These remarks show that China is still in need of foreign investments and products to push forward its economic development and fulfill its domestic demand.

Since China has charted a new course towards better rule of law in its socialist market economy, antitrust enforcement will be a long-term and continuous endeavor. From this perspective, the recent antitrust investigations may be the signal of a comprehensive push towards the rule of law.

[12] Global News, *Li Keqiang: "foreign companies are very welcome in China"* (Jan.22, 2015), http://world.huanqiu.com/article/2015-01/5475014.html.

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The Development of Antitrust Law in the Chinese Automobile Industry: An Evolving Regime

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The Development of Antitrust Law in the Chinese Automobile Industry: An Evolving Regime

Hazel Yin & Ruohan Zhang [1]

I. INTRODUCTION

There was a significant overhaul of the automobile industry in China in 2014. In mid-September 2014, several foreign automobile manufacturers, as well as their authorized dealers, were fined by the local pricing authorities, the provincial counterparts of the National Development and Reform Commission ("NDRC"), for violations of China's Anti-Monopoly Law ("AML"). Around the same time, some new rules and policies were published or being contemplated by the other government authorities, including the State Administration for Industry and Commerce ("SAIC"), the Ministry of Transportation ("MOT"), and the Ministry of Commerce ("MOFCOM").

In fact, China's antitrust authorities started to pay more attention to the automobile industry back in 2012, if not earlier, when the China Automobile Dealers Association carried out a review of industry commercial policies, spare parts supplies, and after-sales services upon the instruction of NDRC, one of the three antitrust authorities in China in charge of enforcement against price-related monopoly conduct.[2]

This article explains the current distribution model in China's automobile industry and how it originated. It then provides a summary of the recent legislation and policies in the industry that are aimed at solving potential antitrust issues. We also discuss areas of uncertainty within the Chinese legal framework and draw comparisons with EU practices.

II. CHARACTERISTICS OF THE CHINESE AUTOMOBILE DISTRIBUTION INDUSTRY

In China, automobile distribution is mainly governed by the *Implementation Measures on the Administration of Automobile Brand Sales ("Measures")*, which were jointly promulgated in April 2005 by MOFCOM, NDRC, and SAIC. The *Measures* facilitated the establishment of a two-tiered distribution network with (i) a general distributor and (ii) authorized dealers, or the so-called 4S (sales, service, spare parts, and survey) stores that prevail in China's automobile distribution industry.

According to the *Measures*, an automobile manufacturer shall appoint an exclusive general distributor, which, under the authorization of the manufacturer, will formulate and

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[2] *See* China is Investigating Automobile Pricing, a report by Reuters, *available at* http://cn.reuters.com/article/chinaNews/idCNCNE97C09Y20130813.

implement its distribution network planning.[3] The *Measures* further provide that an automobile manufacturer, or its general distributor, may only sell automobiles to authorized dealers, and these authorized dealers may only sell to consumers, unless otherwise approved by the manufacturer or its general distributor.[4] The authorized dealers are also required to engage in sales, services, and supply of spare parts of branded cars within their authorization and are prohibited from engaging in any business relating to non-authorized brand cars.[5]

Although the *Measures* do not prohibit dealers from obtaining authorization from multiple automobile manufacturers; in practice, because of commercial registration requirements,[6] each dealer is in fact bound to a single manufacturer.

The *Measures* were introduced at a time when under-developed sales and after-sales markets constrained the further development of China's automobile industry. According to an interview with the head of the Department of Market System Development of MOFCOM, prior to the effectiveness of the *Measures*, the authority did not attach as much importance to automobile distribution as it did to automobile manufacture.[7] However, in the *Policies on the Development of Automobile Industry*, which were published in 2004, it was required that "from 2005, automobile manufacturers shall realize brand sales and services for passenger cars" and that "automobile dealers shall operate their business within the scope as approved by administrations for industry and commerce." The *Measures* set out the details to implement these principles as approved by the State Council.

It is commonly recognized that, in its early stages, the *Measures* contributed significantly to improving the automobile distribution market, strengthening the quality of service of dealers and protecting the rights of consumers. With the development of the market, however, the *Measures* have been criticized for giving rise to an unbalanced position between the automobile manufacturers vis-à-vis the dealers and for being the breeding ground of alleged monopolies in both the sales and the after-sales markets.[8]

III. RECENT LEGISLATION AND POLICIES

While NDRC launched a number of investigations into the automobile industry in 2014, other authorities intervened or expressed their concerns through the publication of a series of legislation and policies. Under the latest legal and policy framework, it appears that diversified forms of distributors will be encouraged to enter the market without the mandatory requirement for brand authorization. Exclusive supply of genuine spare parts is also being challenged, while the supply of comparable spare parts by third parties is being encouraged. Territorial restrictions

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[3] *See* the Measures, Article 3, 6 and 8.

[4] *See* the Measures, Article 18 and 28.

[5] *See* the Measures, Articles 25 and 27.

[6] According to the practice in commercial registration, dealers are exclusively registered with a single brand. *See* Chapter III Part A for more detail.

[7] *See* MOFCOM Expert Interpretation on Measures on Automobile Brand Sales, *available at* http://news.xinhuanet.com/auto/2005-04/01/content_2771453.htm.

[8] *See* Implementation Measures on the Administration of Automobile Brand Sales Create Controversy, a report by CNR.CN, *available at* http://www.cnr.cn/fortune/news/200503/t20050323_504044214.html.

or channel restrictions might also become problematic. The automobile distribution and after-sales markets are facing tremendous challenges.

A. SAIC Proclamation to Cease Registration Requirements for Automobile General Distributors and Automobile Authorized Brand Dealers

In August 2014, SAIC, the authority in charge of commercial registration, published a proclamation announcing that, from October 1, 2014, it would cease to register automobile general distributors and automobile authorized brand dealers. In addition, it announced that the scope of business of all dealers would be automobile sales, without limitation to a specific brand.

Previously, the automobile manufacturer or its general distributor were required to file certain dealer-related documents, including the brand authorization agreement, with SAIC[9] before the dealers could apply for business registration at the local Administration for Industry and Commerce ("AIC").[10] The business scope as indicated on the dealer's business license would be "brand 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*.

However, after the revocation of the registration requirement, in theory a dealer can directly register at its local AIC without pre-authorization from automobile manufacturers and may develop business for multiple brands without going outside its business scope. Since the registration requirement to a certain extent ensures the implementation of the authorized distribution system required by the *Measures*, some industry experts consider that the abolition of this registration requirement indicates the *Measures* will undergo a significant change.[11]

B. SAIC Guiding Opinion on Enhancement of Automobile Market Supervision

Two months after the proclamation was published, SAIC issued the *Guiding Opinion Regarding the Supervision on Automobile Market* ("SAIC Guiding Opinion"), as an effort to implement the *Several Opinions on Promoting Fair Market Competition and Safeguarding Normal Market Order* issued by the State Council.

The *SAIC Guiding Opinion* emphasizes the protection of the legitimate interests of "various market players" in the automobile market and free choice for consumers. It also reaffirms the revocation of the registration system for automobile general distributors and authorized brand dealers, so as to "encourage diversified business models and market players." It sends a clear signal to the industry that the current model of authorized distribution system is being challenged.

Moreover, the *SAIC Guiding Opinion* also emphasizes that the authority will focus on customer complaints and media exposure, with enhanced supervision and enforcement against monopoly agreements and abusive conduct in the automobile industry. SAIC also vows to

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[9] *See* the Measures, Article 9 and 10.

[10] *See* the Measures, Article 13, which provides that "when applying for registration, dealers shall bring the certificate of Provider's filing with SAIC to the local Administration for Industry and Commerce."

[11] *Expert Interpretation of the Proclamation re End of Brand Registration*, a report by CNAUTONEWS.COM, *available at* http://www.cnautonews.com/jrtt/201408/t20140812_320410.htm.

formulate and promote the use of standard automobile sales and maintenance agreements to delineate the rights and obligations of business operators and consumers.

SAIC is responsible for enforcement in respect of non-price-related monopoly conduct under the AML. Like the legal framework of most other jurisdictions, the conduct rules under the AML also regulate monopoly agreements and abuse of a dominant market position. However, unlike most other jurisdictions, where the antitrust enforcement authority is vested in a single agency, the enforcement authority of Chinese conduct rules is split between NDRC and SAIC, depending on whether the conduct is price-related or non-price-related. In fact, price-related monopoly agreements are a major target of the AML, as stipulated in Article 13(1)(1), which prohibits horizontal price-fixing agreements, and Article 14, which prohibits vertical resale price-maintenance agreements. The recent antitrust decisions against automobile manufacturers and their dealers were based on those provisions.

On the other hand, the AML does not expressly prohibit non-price-related vertical monopoly agreements. Article 14(3) of the AML provides a catch-all clause granting antitrust agencies the authority to find other non-price-related vertical agreements to be monopolistic. However, in practice, this clause has not yet been applied in publicized decisions.

Although the *SAIC Guiding Opinion* is quite high-level and general, it at least suggests that SAIC is paying particular attention to anticompetitive conduct in the automobile industry. It is expected that SAIC may publish more detailed guidelines on what constitutes a non-price-related vertical monopoly agreement. If the EU framework is followed, it would not be surprising if more vertical restrictions, such as territorial, customer, or channel restrictions, were regulated in the future. This would directly influence the way market players do business in the automobile industry.

C. MOT Guiding Opinion on Improvement of Automobile Repair and Maintenance Industry

In September 2014, after soliciting public opinions,[12] the MOT and nine other ministries jointly issued the *Guiding Opinion on Improvement of Automobile Repair and Maintenance Industry ("MOT Guiding Opinion")*, aimed at upgrading the after-sales service sector and improving service qualities. The *MOT Guiding Opinion* was drafted on the basis of MOT's survey of the automobile maintenance industry.[13] Notably, it encourages broadening spare parts supply channels. It also targets the abuse of warranty clauses and requires the mandatory release of technical information for repair and maintenance, so that independent maintenance enterprises are able to compete more effectively with authorized ones.

1. Broadening Supply Channels of Spare Parts

"Genuine spare parts" generally refers to spare parts manufactured by automobile manufacturers or their OEMs. Currently in China, exclusive supply and exclusive purchase

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[12] The draft version of the MOT Guiding Opinion was published by MOT for comment on June 24, 2014. *See* the Draft Version of the MOT Guiding Opinion and the Notice for Soliciting Opinions, *available at* http://www.moc.gov.cn/zfxxgk/bnssj/dlyss/201406/t20140630_1642674.html.

[13] Liu Xiaoming, Head of Traffic Division of the Ministry of Transport, commented in an interview, *available at* http://www.moc.gov.cn/zhuzhan/ft2014/qichewxyshjzhx/wenzishilu/index_3458.html.

requirements are not uncommon in the after-sales market. In an exclusive supply arrangement, a spare parts supplier will sell exclusively to an automobile manufacturer. The latter will then resell those spare parts exclusively to authorized maintenance enterprises. Authorized maintenance enterprises are normally prohibited from reselling the spare parts to other maintenance enterprises, making them the only source for genuine spare parts in the after-sales market.

To promote the fair competition in the repair and maintenance market and protect freedom of choice by customers, the *MOT Guiding Opinion* (i) encourages genuine spare parts producers to sell genuine spare parts and spare parts with their own trademarks directly in the after-sales market, (ii) allows authorized maintenance enterprises to resell genuine spare parts to unauthorized maintenance enterprises or consumers, and (iii) states that all maintenance enterprises and consumers should have the same access to high quality spare parts.

In fact, exclusive dealing is not a *per se* violation of Article 13 or Article 14 of the AML. As mentioned above, it is not a type of vertical monopoly agreement explicitly prohibited by the AML. However, if a company has a dominant market position, exclusive dealing without justification could constitute an abuse of dominance, in violation of Article 17(4) of the AML. In China's automobile sales market, it may be difficult to establish that any major automobile manufacturer holds a dominant position, as competition is fierce and none of the automobile manufacturers holds a significant market share.[14]

In the after-sales market, however, a number of foreign cases have suggested that the relevant market should be narrowly defined as the brand-specific market.[15] The European Commission considers that the markets for repair and maintenance services and for the distribution of spare parts are generally brand-specific in nature and that, insofar as a market exists for after-sales services that is separate from the sale of new motor vehicles, that market is considered to be brand specific.[16] It appears that the approach to exclusive supply requirements in the *MOT Guiding Opinion* is generally in line with the EU antitrust law principles.[17] The *MOT*

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[14] *See*, *Top 20 of Automobile Seller in China 2013: Self-Owned Brand Accounts for 1/3*, a report by Gasgoo, *available at* http://auto.gasgoo.com/News/2014/02/14013015301560282419768ALL.shtml.

[15] For example, in *Eastman Kodak Co. v. Image Tech. Servs.*, 504 U.S. 451, 481-482 (U.S. 1992), the Court stated "The relevant market for antitrust purposes is determined by the choices available to Kodak equipment owners. Because service and parts for Kodak equipment are not interchangeable with other manufacturers' service and parts, the relevant market from the Kodak equipment owner's perspective is composed of only those companies that service Kodak machines."

[16] *See* the European Commission's Supplementary Guidelines on Vertical Restraints in Agreements for the Sale and Repair of Motor Vehicles and for the Distribution of Spare Parts for Motor Vehicles, 2010/C 138/05, ¶¶15 and 57.

[17] For example, Article 5 of the European Commission's Motor Vehicle Block Exemption Regulation (No 461/2010) prohibits restrictions on the sales of spare parts for motor vehicles by members of a selective distribution system to independent retailers which use those parts for the repair and maintenance of a motor vehicle; restrictions on the ability of a supplier of spare parts to sell those goods to authorized or independent distributors, authorized or independent repairers or end users; and restrictions on a supplier of component parts used for the initial assembly of motor vehicles to place its trade mark or logo effectively and in an easily visible manner on the components supplied or on spare parts. Further, Article 4(d) of the Vertical Block Exemption Regulation (No 330/2010) prohibits restrictions on the ability of a supplier of components to sell those components as spare parts to end-users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods.

Guiding Opinion provides clearer guidance than the AML in relation to the business models in the automobile industry.

It is of note that the *MOT Guiding Opinion* does not address exclusive purchase requirements imposed on authorized dealers by automobile manufacturers or their general distributors. This appears to suggest that the *MOT Guiding Opinion* is more tolerant of exclusive purchase requirements than exclusive supply requirements.

2. Preventing the Misuse of Warranty Clauses

The *MOT Guiding Opinion* stipulates that automobile manufacturers should not limit or intervene with consumers' independent choice of maintenance enterprises, or refuse to provide warranty services on the basis that the automobile has been maintained by a non-authorized maintenance enterprise within its warranty period.

According to the *MOT Guiding Opinion*, consumers should be given the right to choose any maintenance enterprise, whether authorized or not, for maintenance services.

According to the *Regulation on Maintenance, Replacement, and Return of Household Automobile ("Three Warranties Regulation")*, automobile manufacturers and maintenance enterprises may refuse to provide warranty cover in respect of damage caused by (a) consumers' wrongful conduct, or (b) consumers' failure to maintain or repair in accordance with the manual. It is foreseeable that, with the proliferation of non-authorized maintenance entities, disputes will arise between the automobile manufacturers and maintenance enterprises on the one hand, and consumers on the other, as to what exactly is the cause of a damaged car and who should bear the responsibility for such damage. To address such disputes, authoritative independent institutions are required. As mentioned in the *MOT Guiding Opinion*, third-party dispute mediation institutions should be established and improved with "available channels, efficient services, authoritative techniques, and justified decisions."

The *MOT Guiding Opinion* only prohibits refusals to provide warranty cover during the "three warranties" period. It does not address extended warranties which consumers may purchase after the initial warranty period has expired. Therefore, it appears that automobile manufacturers or general distributors are permitted to impose restrictions in extended warranties that prevent consumers from using non-authorized maintenance enterprises.

Similarly, in the European Union, a vehicle manufacturer can include restrictions relating to servicing or spare parts in an extended warranty that is bought by a consumer from an authorized repairer or from the vehicle supplier some years after the purchase of the vehicle.[18] Such restrictions may include making the warranty conditional on the end user having repair and maintenance work that is not covered by the warranty carried out within the vehicle manufacturer's authorized repair networks. The warranty conditions may also require the use of the vehicle manufacturer's brand of spare parts in respect of replacements not covered by the warranty terms.

[18] *See* FAQs 1-5 of the European Commission's Frequently Asked Questions on the application of EU Antitrust Rules in the Motor Vehicle Sector, 27 August 2012.

The rationale behind the EU practice is that, years after a vehicle is purchased, authorized dealers do not enjoy the same degree of privileged access to consumers as they do in the period shortly after the purchase. As a consequence, alternative providers of extended warranties are unlikely to face significant barriers preventing them from offering their products to vehicle owners. In such circumstances, the European Commission considers it unlikely that independent repairers could face a significant foreclosure effect even if warranties issued by providers contain servicing restrictions.

3. Publishing Automobile Maintenance Technology Information

The *MOT Guiding Opinion* stipulates that, from January 1, 2015, automobile manufacturers (including enterprises that import and sell automobiles in China) must publish automobile maintenance technology information in respect of new automobiles that enter the Chinese market. For existing models, the deadline to publish such information is December 31, 2015. The information must be published without discrimination and delay to both authorized and independent maintenance enterprises, in available information forms, convenient for access, and for reasonable fees. A failure to comply with these requirements will result in the removal of the relevant model from the Announcement of Automobile Manufacturers and China Compulsory Certification ("CCC"), meaning that the relevant automobile manufacturer would be unable to sell that model in China.

According to a MOT official, there is a monopoly over access to maintenance technology information in the market.[19] Given access to technical information, as well as genuine spare parts, independent enterprises will be more competent to provide a satisfactory service.

There are currently no detailed rules about publishing information, other than the principles set out in the *MOT Guiding Opinion*. It is unclear what the scope is of information to be published and whether there will be any exceptions to the requirements. Further explanation and guidance is needed to understand how this requirement will operate in practice.

In the European Union, qualitative selective distribution agreements concluded with authorized repairers and/or parts distributors may be caught by competition law if one of the parties acts in a way that forecloses independent operators from the market; for instance, by failing to release technical repair and maintenance information to them.[20] Further, where a supplier is the only source of all the technical information needed to perform repair and maintenance work on motor vehicles of its brands, agreements with its authorized repairers and/or parts distributors may be caught by the prohibition against restrictive agreements if the supplier fails to provide independent operators with appropriate access to its brand-specific technical repair and maintenance information.[21] Exceptionally, a failure to provide such information may be justified for safety or security reasons. However, this is unlikely where the

[19] Liu Xiaoming, Head of Traffic Division of the Ministry of Transport, commented in an interview, *available at* http://www.moc.gov.cn/zhuzhan/ft2014/qichewxyshjzhx/wenzishilu/index_3458.html.

[20] *See* ¶62 of the European Commission's supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles.

[21] *See* ¶63 of the European Commission's supplementary guidelines on vertical restraints in agreements for the sale and repair of motor vehicles and for the distribution of spare parts for motor vehicles.

supplier is likely to be the only source for the full range of technical information relating to vehicles of its brands.[22]

The *MOT Guiding Opinion* has taken a step beyond the AML in regulating the automobile spare parts and maintenance market. However, except for disqualifications for failure to release technical repair and maintenance information, the *MOT Guiding Opinion* does not contain any penalty provisions. It remains to be seen how the opinion will be enforced in practice.

D. MOFCOM Draft Measures on Automobile Sales

Since the second half of 2014, MOFCOM has circulated several rounds of the Draft Measures on Automobile Sales ("*Draft Measures*"), which will ultimately replace the existing *Measures*, for consultation among various government departments and industry associations.[23] MOFCOM is one of the three antitrust enforcement agencies in China in charge of merger control. However, the Department of Market System Development is taking the lead in drafting the *Draft Measures*, rather than the Anti-Monopoly Bureau of MOFCOM.

The most distinctive feature of the latest version of the *Draft Measures* is that the measures play down the concept of "authorized dealers" and encourage other types of sales models, including automobile supermarkets, automobile trade centers, and online automobile markets to compete with the current 4S stores.[24] This change is in line with the *SAIC Opinion* and the *MOT Guiding Opinion*. However, in the near future, authorized distribution systems will probably continue to be the principal model of automobile distribution in China, given that authorized dealers have more experience in sales of automobiles and the provision of after-sales services to consumers.

Moreover, the *Draft Measures* include a number of provisions that are particularly aimed at prohibiting monopoly conduct. Some provisions in the *Draft Measures* echo what is stipulated in the *AML*, such as prohibiting resale price maintenance,[25] whereas other provisions are not expressly featured in the *AML*, such as prohibition of territorial restrictions and channel restrictions. From this point of view, the *Draft Measures* go further than the *AML* and take a more proactive approach in regulating the automobile industry.

Despite the relatively comprehensive rules, the *Draft Measures* are vague on certain issues. For territorial restrictions, the *Draft Measures* only stipulate that the automobile manufacturer or its general distributor may not limit sales to customers according to their domicile.[26] Strictly construed, this provision only forbids restrictions on passive sales, where consumers visit dealers on their own initiatives. For active sales, where dealers establish a show

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[22] *See* FAQs 15 of the European Commission's Frequently Asked Questions on the application of EU Antitrust Rules in the Motor Vehicle Sector, 27 August 2012.

[23] *See* Change 4S Model, Countdown to the Revision of the Implementation Measures on the Administration of Automobile Brand Sales, a report by EEO.com.cn, *available at* http://www.eeo.com.cn/2014/1017/267438.shtml.

[24] *Id.*

[25] *See,* New Measures on Automobile Sales in the Pipeline, a report by Zhongshan Business Newspaper Auto Weekly, *available at* http://auto.zsnews.cn/archive.php?aid=560986.

[26] *Id.*

room or take other promotional activities in a region other than the one it is contractually responsible for, the automobile manufacturer or its general distributor may arguably impose a restriction without violating the *Draft Measures*.

This approach is also adopted by the European Commission. For example, the *Vertical Block Exemption Regulation* permits restrictions of active sales (but not passive sales) into an exclusive territory reserved to another supplier, provided the relevant agreement meets the requirements stipulated in the Regulation.[27]

As for channel restrictions, the *Draft Measures* stipulate that the automobile manufacturer or its general distributor may not prohibit cross-selling among "dealers selling their automobiles."[28] In contrast, the *Measures* as currently in force implicitly prohibit cross-selling, as dealers are only allowed to sell to consumers.[29] The *Draft Measures* seem to be consistent with the EU competition rules on this issue, as the *Vertical Block Exemption Regulation* prohibits restrictions on cross-supplies between distributors within a selective distribution system.[30]

There is a little uncertainty though as to whether this provision could be interpreted more broadly to even allow an authorized dealer to sell automobiles to independent dealers, in which case it would be even more aggressive than the EU rules. This would arguably undermine the authorized distribution system, which recognizes that high-tech products, such as automobiles, should be sold by properly trained staff who understand the product and are able to provide appropriate after-sales services.

The *Draft Measures* also cover an issue which is left open in the *MOT Guiding Opinion*; namely, the exclusive purchase requirements. The *Draft Measures* would require automobile manufacturers and their general distributors to ensure consumers are given a free choice for "general" spare parts,[31] and prohibit the imposition of exclusive purchase requirements on dealers for the sale of "general" spare parts. When the *Draft Measures* are formalized, the challenge for an automobile manufacturer or its general distributor will be to distinguish the so-called "general" spare parts from the others, unless it abandons the exclusive purchase requirements for spare parts entirely. The *Draft Measures* would not leave much leeway for an automobile manufacturer or its general distributor on this issue.

In contrast, under the EU rules, an automobile manufacturer or its general distributor may be permitted to impose non-compete obligations on a dealer; for example, obliging the

[27] Article 4(b) of Commission Regulation No 330/2010 on the Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices, 20 April 2010 ("Vertical Block Exemption Regulation"). *See also*, ¶51 of the European Commission's Guidelines on Vertical Restraints.

[28] *See supra* note 25

[29] *See* the Measures, Article 28.

[30] *See* Article 4(d) of the Vertical Block Exemption Regulation.

[31] *See supra* note 25.

dealer to purchase more than 80 percent of their total purchases of general spare parts from the automobile manufacturer or its general distributor.[32]

As mentioned above, the *Draft Measures* cover some provisions already included in the AML, but also provide rules in respect of conduct that is not explicitly banned in the AML. It is reasonable to expect that once the *Draft Measures* are formally introduced, automobile manufacturers may need to carry out an extensive review of their daily operations to ensure compliance.

E. Development of Parallel Imports

The Chinese government is also encouraging parallel imports to try to introduce more competition in the automobile industry. In the automobile industry, parallel imports generally refer to imports through legitimate channels without authorization from general distributors. According to the existing *Measures*, foreign automobile manufacturers are required to authorize or establish domestic enterprises to be their general distributor for sales of imported automobiles in China. Nevertheless, parallel imports have long existed in the Chinese automobile market. According to the *Regulations on Imports and Exports* and *Regulations on Mandatory Product Certification*, any enterprises that are granted an automobile imports license by MOFCOM may legitimately import automobiles through customs, so long as such automobiles have passed the relevant quality inspections. In other words, parallel imported automobiles are allowed, but only those imported from independent channels.

It was hoped that, when the Shanghai Free Trade Zone was established in 2013, the legal status of parallel imports would be clarified. In November 2014, the General Office of the State Council issued the *Opinion on Improvement of Imports.*[33] The *Opinion* calls for modification to regulations on automobile brand sales and also suggests introducing a pilot project for parallel imports to be formally conducted in the Shanghai Free Trade Zone. In January 2015, the Shanghai Municipal Commission of Commerce, together with four other administrations, issued the *Notice on the Launch of Pilot Project for Parallel Imports in Shanghai Free Trade Zone.*[34] The notice sets certain thresholds and procedural requirements for applicants. It is understood that the Shanghai Waigaoqiao (Group) Co. Ltd. plans to establish a trade center in the Shanghai Free Trade Zone, providing both sales and after-sales services.

In practice, parallel imported automobiles may enjoy a significant price advantage, although they do face certain barriers. First, most parallel imported automobiles must meet

[32] The Vertical Block Exemption Regulation permits a motor vehicle supplier and a distributor to agree on a non-compete obligation, causing the buyer not to manufacture, purchase, sell or resell goods or services which compete with the contract goods or services, or imposing an obligation on the dealer to purchase from the suppliers or from another undertaking designated by the supplier more than 80 percent of the buyer's total purchases of the contract goods or services and their substitutes on the relevant market. This is provided that the market share test in the Regulation is satisfied, the agreement is not between actual or potential suppliers in the same product market, and the agreement does not contain any hardcore restrictions identified in Article 4 of the Regulation. Non-compete obligations will only be exempt if they comply with the conditions set out in Article 5 of the Regulation.

[33] *Available at* http://www.gov.cn/xinwen/2014-11/06/content_2775819.htm

[34] *Available at* http://www.scofcom.gov.cn/service/search/content.jsp?contentid=MjM3NDcx

certain Chinese standards. In order to register an imported automobile, the importer must make necessary modifications to fully comply with these standards.

Second, before entering the China market, imported automobiles must hold CCC certification, which involves a considerable application fee and the provision of four automobiles for each model to carry out safety tests. More importantly, as required by the *Regulation on Compulsory Product Certification*, parallel importers must submit relevant agreements with automobile manufacturers before applying for the CCC certification.[35]

Third, according to the *Three Warranties Regulation*, sellers are primarily responsible for warranties. However, most parallel importers are not capable of providing proper maintenance services. Alternatively, importers can purchase commercial insurance on behalf of their consumers. Even though the expense is covered, consumers may still have difficulties with after-sales maintenance, because the spare parts and technical information for maintenance and repair of foreign-standard-automobiles may be different from those for Chinese-standard-automobiles.

Given these challenges, the development of parallel imports in the automobile industry is proving to be a slow and difficult process.

IV. CONCLUSION

The AML has been in effect for more than six years and has started to reshape the business models of almost all industries in China, to differing degrees. The automobile industry in particular has become a key focus for not only the antitrust authorities, but also the competent authorities responsible for the automobile industry in China. It is expected that there will be an overhaul of the current prevailing business models in the industry. However, as the legal framework is still being developed, uncertainties remain, which create challenges for automobile manufacturers and their dealers. It may be advisable to start to consider whether mechanisms and agreements in place need to be adapted in order to keep up with the fast-evolving legal environment in China.

[35] *See* the procedure for CCC application, *available at* http://www.cnca.gov.cn/ywzl/rz/qzxcpzl/zdjs/200609/t20060925_1610.shtml.

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International Standards of Procedural Fairness and Transparency in Chinese Investigations

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International Standards of Procedural Fairness and Transparency in Chinese Investigations

Fay Zhou, John Eichlin, & Xi Liao[1]

I. INTRODUCTION

Recent years have witnessed intensified enforcement activities by Chinese enforcement authorities targeting a broad range of alleged anticompetitive conduct under the Anti-Monopoly Law ("AML"). The National Development and Reform Commission ("NDRC") and the State Administration for Industry and Commerce ("SAIC"), together with their regional offices, have firmly established their position in the international spotlight with a series of high-profile enforcement actions against domestic and foreign companies.[2] Headline cases in recent years involving multinational companies include fines related to the global auto parts cartel investigation, probes of resale price maintenance ("RPM") by foreign auto manufacturers, and high-profile investigations into Qualcomm and Microsoft reportedly focused on abuse of dominance and patent incensing practices.

With the attention raised by these high-profile investigations, these authorities have drawn international scrutiny for both the substance of the investigations and how they have been conducted. Procedurally, critics have argued that these investigations have lacked transparency and that the targets were not afforded sufficient protections under international norms of procedural fairness. In particular, they have argued that many investigations have been characterized by limited opportunity for companies to prepare potential defenses. Anecdotal accounts have also circulated that parties under investigation have been denied legal representation and subject to intimidation tactics by the authorities seeking confessions or price concessions. While these concerns may be overstated in certain areas and do not necessarily reflect current enforcement practices, they serve as a valuable framework for assessing international perceptions of procedural fairness and transparency in China.

This article provides an overview of some of the areas of investigation procedure in China that have drawn criticism under international procedural fairness and transparency standards,

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[2] NDRC and SAIC have distinct but often overlapping enforcement authority over different forms of anticompetitive conduct under the AML. Drawing from its traditional function as a price regulator, NDRC and its regional offices have enforcement authority over price-related anticompetitive agreements such as horizontal price-fixing, resale price maintenance, and excessive, predatory, and discriminatory pricing. SAIC and its regional offices are responsible for enforcement related to non-price restraints such as market allocation, output restrictions, vertical restraints other than resale price maintenance, refusal to deal, exclusive dealing, tying/bundling, and discriminatory treatment not related to pricing. Each also has jurisdiction over enforcement of related statutes, like the Price Law and the Anti-Unfair Competition Law, respectively.

including a meaningful opportunity to prepare a defense, the right to the protections of legal counsel, and transparency in decision-making.

The article also provides insight into the Chinese authorities' reaction to the international criticism and how they have sought to provide companies with greater comfort on procedural protections. These efforts have included measures to further develop their best practices as well as to clarify existing enforcement practices where there may be a misunderstanding in the international business community.

Finally, the article discusses how certain important procedural protections can be further improved and developed. Overall, the Chinese enforcement authorities should be recognized for their receptiveness to external comments in developing their enforcement practices and for their willingness to promote further improvements to address international concerns about procedural fairness and transparency.

II. OVERVIEW OF ENFORCEMENT PROCEDURES IN CHINA

While the AML has been in effect since 2008, enforcement has only really ramped up in the past two years. In a conscious effort to build credibility, Chinese authorities have been regularly consulting on international practices with a range of antitrust practitioners, foreign antitrust authorities, and multinational companies. As a result, Chinese investigative rules and procedures draw elements from other regimes, while also retaining features unique to the Chinese legal system and enforcement regime. While the authorities have been building experience and sophistication, there are still growing pains as the authorities incorporate these procedures into their enforcement practices—particularly in the decentralized regional offices in each province.

As with many other jurisdictions, investigations may originate from various sources at both the provincial and national levels. Complaints from competitors, customers, or suppliers tend to be the most important sources of investigation. The authorities also conduct broader sector inquiries consistent with their enforcement focus. In sector inquiries, NDRC first sends generic questionnaires to a variety of market players and subsequently targets certain companies for follow-up inquiries or even formal investigations. For example, in its probe of the automotive sector, NDRC reportedly began with an "industry sweep" sending requests for information to many major multinational car manufacturers. NDRC has also reportedly circulated questionnaires in other industries that are a high enforcement priority, including the pharmaceutical sector.

The investigation could also start with a meeting with the target's management or, in some cases, dawn raids of the target businesses. Officials from both authorities have relatively broad investigatory powers under the relevant regulations and general enforcement practices. Namely, officials can enter into companies' business premises for investigation, inquire into

companies' employees and interested parties, review and copy companies' books and records, seal and detain evidence, and check companies' bank accounts.[3]

As the authorities gradually accumulate experience, their investigative techniques are becoming increasingly sophisticated. NDRC in particular has developed task forces to carry out the dawn raids and follow-up investigations, including a range of specialized experts in law, technology, and accounting. They have also been using increasingly high-tech investigative techniques, including using forensic IT techniques to recover deleted emails.

After the initial dawn raid or meeting with a target, the investigation will typically continue through a series of engagements with the company. Investigations may entail a series of information requests and site visits supported by the collection of a significant amount of documentary evidence, as well as interviews with relevant employees. The authorities will also typically engage with the target of the investigation on potential settlements or remedies from an early stage, reportedly seeking admissions and cooperation under the leniency rules to support the settlement.

After the case team completes the initial investigation, they are directed to prepare an internal report for central decision-making. This report includes a recommendation based on the relevant evidence and any explanations or defenses raised by the parties.[4] The authority issues an advance penalty notice to the target if it concludes there is a violation of the AML, setting out the basis for their findings and the proposed penalty. The target then has the formal right to make submissions in response to this notice and request a hearing on the merits.[5] Finally, the parties have a formal right to seek administrative or judicial reviews of any final penalty submission.

The pace of the investigations can vary dramatically. Some cases have had final decisions announced only a few months from the launch of formal investigation, such as NDRC's 2013 investigation into RPM practices by milk powder companies. Other cases have lasted several years, including the reported investigations of TetraPak that appear to focus on more complex abuse of dominance theories.

III. INTERNATIONAL CONCERNS AND THE AUTHORITIES' RESPONSE

With intensified enforcement, the international business community has raised concerns about both the substance and procedure of investigations in China. Procedurally, foreign businesses have increasingly expressed concerns about the lack of opportunities to present an effective defense and lack of transparency. Anecdotal accounts of intimidation tactics preventing effective legal representation and judicial review have even been cited.

While some of these reports may be overstated or reflect a misunderstanding of current enforcement practices, they have prompted significant concerns for the broader international business community. Based on these reports, international trade associations from both the

[3] Regulation on the Anti-Price Monopoly Administrative Enforcement Procedure, [2010] NDRC Order No. 8, Dec. 29, 2010, Article 6; Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position, [2009] SAIC Order No. 42, Jun. 5, 2009, Article 10.

[4] Rules on the Hearing and Review of Cases Involving Price-Related Administrative Penalties, [2013] NDRC Price Supervision and Anti-Monopoly Department Order No.1950, Sep. 30, 2013, Article 14.

[5] *Id.*, Article 12.

United States and Europe have increasingly vocalized their concerns and sought political engagement on reforms. In August 2014, the European Chamber of Commerce publically expressed concerns about the conduct of investigations in China.[6] Shortly after, the U.S.-China Business Council raised similar concerns.[7] The U.S. Chamber of Commerce has published a lengthy report on AML enforcement in China, arguing that Chinese authorities need to improve the quality and fairness of rulings.[8] Further, officials from the U.S. antitrust agencies have publicly expressed some concerns about the procedural protections afforded to foreign companies in China.[9]

The authorities have sought to dispel concerns of the international business community by clarifying their enforcement practices and making some changes to support their arguments. In September 2014, enforcement officials from NDRC, SAIC, and the Ministry of Commerce ("MOFCOM")[10] held a joint press conference defending high-profile investigations of companies like Microsoft and Qualcomm.[11] They assured the international community that the enforcement activities were fair, transparent, and not targeted at foreign firms.

The central authorities have expressed their ongoing commitment to ensure that they strictly follow statutory limits on their authority, procedures, and requirements under the law. They have committed to provide the parties with the right to state their cases and to defend themselves, notifying the parties of the facts, reasons, and basis on which penalties are decided and of the rights that they enjoy under the law. Moreover, China has committed to treating all business operators equally in its enforcement. These statements have since been reiterated in the commitments by the Chinese delegation to the 25th U.S.-China Joint Commission on Commerce

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[6] European Union Chamber of Commerce in China, Statement on China AML-Related Investigations (Aug. 2014), *available at* http://www.europeanchamber.com.cn/en/press-releases/2132/european_chamber_releases_statement_on_china_aml_ related_investigations ("Inspections must not prejudge the outcome of the investigation and full rights of defence must be afforded to the companies in question. Disconcertingly, the European Chamber is not convinced that this has systematically been the case in China's recent investigations").

[7] *See*, e.g., *US-China Business Council, Competition Policy and Enforcement in China* (Sept. 2014), *available at* https://www.uschina.org/reports/competition-policy-and-enforcement-china ("Some companies [...] have raised concerns that there is undue pressure to confess they have violated the AML. In these cases, company representatives are often not told why they are under investigation or on what grounds an investigation has been launched, but they are still told they will face a reduced penalty if they 'cooperate'").

[8] U.S. Chamber of Commerce, *Competing Interests in China's Competition Law Enforcement* (Aug. 2014), *available at* https://www.uschamber.com/report/competing-interests-chinas-competition-law-enforcement-chinas-anti-monopoly-law-application ("AML enforcement give[s] rise to growing concern about the quality fairness of enforcement, and [...] raise[s] legitimate questions about China's commitment to the global antitrust commons, which is at the least as valuable to China as any other country").

[9] *See*, e.g., FTC Commissioner Maureen K. Ohlhausen, Speech, *Antitrust Enforcement in China – What Next?* (New York, Sept. 6, 2014), *available at* http://www.ftc.gov/public-statements/2014/09/antitrust-enforcement-china-what-next-second-annual-gcr-live-conference; FTC Chairwoman Edith Ramirez, Speech, *Core Competition Agency Principles: Lessons Learned at the FTC* (Beijing, May 22, 2014), *available at* http://www.ftc.gov/public-statements/2014/05/core-competition-agency-principles-lessons-learned-ftc-keynote-address.

[10] While SAIC and NDRC have joint enforcement authority related to anticompetitive conduct, MOFCOM is the enforcement authority with sole responsibility for merger review and enforcement.

[11] Press Conference on Antitrust Enforcement Work Organised by the State Council State Council Information Office, *available* at http://www.scio.gov.cn/xwfbh/xwbfbh/wqfbh/2014/20140911/.

and Trade ("JCCT") and by the Chinese enforcement authorities in dialogues with foreign antitrust authorities.[12]

IV. ASSESSMENT UNDER INTERNATIONAL STANDARDS

Basic procedural protections of a party under investigation are widely regarded as fundamental to the rule of law and international acceptance of an enforcement regime. Although global antitrust authorities vary significantly in their procedures and local legal systems, international practice recognizes as a general rule of procedural fairness that parties should have the right to be heard and should be able to have effective representation during the proceedings.[13] In order to be able to effectively prepare a defense, a party needs transparency on the relevant evidence and the legal theory of the claim against it. To support this environment, decisions must further provide sufficient detail about their legal and factual grounds. These procedural protections not only support international enforcement norms, but also more generally increase the effectiveness and accuracy of the enforcement process. Preparation of reasoned decisions also gives broader clarity into the enforcement practices to enhance the legitimacy of the enforcement process as a whole.

Although still relatively inexperienced, given the short enforcement history for the AML in China, the enforcement authorities have demonstrated a commitment to incorporating international standards. The recent statements by high-level Chinese authorities should be recognized as reinforcing or establishing positions on enforcement practices that are directionally in line with best practices. Several new initiatives also appear to have been implemented in practice, including, for example, recent steps to increase transparency by releasing prior decisions. However, the commitments remain high-level and need to be further demonstrated in practice across the authorities and their local offices. They will also need to be supported by more detailed implementing regulations.

A. Opportunity to Present an Effective Defense

The AML provides a formal right of defense to parties under investigation, including a right to present their explanations and arguments during the course of an investigation.[14] The implementing regulations on procedure of NDRC and SAIC also provide the party under investigation the right to submit a defense.[15] However, there is no express right of access of the authority's enforcement file, and the formal notice of the claims may be provided too late in the investigation in practice for the target to have a meaningful opportunity to respond. Although

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[12] US-China Joint Fact Sheet on 25th Joint Commission on Commerce and Trade (Dec. 2014), *available at* http://www.commerce.gov/news/fact-sheets/2014/12/29/us-china-joint-fact-sheet-25th-joint-commission-commerce-and-trade.

[13] *See* Organisation for Economic Co-operation and Development ("OECD"), *Report on Procedural Fairness and Transparency* (April 2012), *available at* http://www.oecd.org/competition/abuse/proceduralfairnessandtransparency-2012.htm.

[14] Article 43 provides that "[t]he business operators under investigation and interested parties are entitled to make statements. The Anti-Monopoly Enforcement Authority shall verify the facts, explanations and evidence brought forward by the business operators under investigation and interested parties."

[15] Regulation on the Anti-Price Monopoly Administrative Enforcement Procedure, [2010] NDRC Order No. 8, Dec. 29, 2010, Article 11; Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position, [2009] SAIC Order No. 42, Jun. 5, 2009, Article 13.

enforcement practice and recent decisions have confirmed that the authorities do engage with targets on the merits of the case, there are also still lingering reports that targets may be denied an opportunity to fully consider the relevant evidence.[16]

The procedural right to evidence in the file is well established in international practice. Under the European Union rules, for example, the European Commission must issue a detailed Statement of Objections and grant the target access to a broad range of materials documenting the evidence in its file.[17] Although the United States does not recognize a formal right to access the files of the antitrust authorities, defendants typically are given notice of the claims against them in significant detail from an early stage of the investigation. Under procedural due process standards, defendants are also entitled to a broad range of discovery and penalties generally cannot be imposed without a public trial or administrative hearing on the evidence.

In response to concerns about limited opportunities for parties to effectively exercise their rights of defense, China committed in the JCCT meeting to notify parties of the facts, reasons, and basis according to which the decision is to be made.[18] To follow through on this commitment, the Chinese authorities should grant further procedural protections to ensure the party under investigation has an opportunity to access, from an early stage, at least the key documents based on which the authorities pursue the case.

Although the parties are entitled to a formal notice of the evidence against them and the proposed penalty, this notice is provided in practice only shortly before the penalty is issued. At this stage, the proposal may be viewed as nearly final and there is limited opportunity prepare meaningful defenses on the merits. Accordingly, steps should be taken to ensure that a formal statement of the claims and evidence against a target is provided earlier. Further engagement may also be necessary at an institutional level to ensure that the right of defense is clearly recognized at all levels, including the regional offices in each province.

B. Effective Legal Representation

To support international enforcement norms, parties must be assured of the right of access to effective legal representation.[19] This generally includes the right to be represented by experienced counsel in engagements with the authorities, as is standard practice in most jurisdictions. In the early years after the implementation of the AML, parties were unsure

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[16] US-China Business Council, Competition Policy and Enforcement in China (Sept. 2014), *available at* https://www.uschina.org/reports/competition-policy-and-enforcement-china ("Companies [raise] concerns about transparency and information-sharing during competition reviews. […] This makes it difficult for companies to be able to place complaints in context or to address specific concerns.")

[17] Article 27(2) of Regulation (EC) No 1/2003 and Articles 15 and 16 of the Implementing Regulation (EC) No 773/2004; Commission Notice on the rules for access to the Commission file in cases pursuant to Articles 81 and 82 of the EC Treaty of 2005 and Council Regulation (EC) No 139/2004, Article 18(2).

[18] *See* US-China Joint Fact Sheet on 25th Joint Commission on Commerce and Trade (Dec. 2014), *available at* http://www.commerce.gov/news/fact-sheets/2014/12/29/us-china-joint-fact-sheet-25th-joint-commission-commerce-and-trade.

[19] *See* U.S. Chamber of Commerce, Competing Interests in China's Competition Law Enforcement (Aug. 2014), *available at* https://www.uschamber.com/report/competing-interests-chinas-competition-law-enforcement-chinas-anti-monopoly-law-application (noting that barring parties' participation alongside foreign or local counsel "contributes to a perception of bias and unfairness").

whether external counsel were entitled to be present at all during the course of an investigation under the AML. Anecdotal reports even suggested a misunderstanding that enforcement authorities may view the involvement of external legal counsel as equivalent to obstruction.[20]

The Chinese enforcement authorities have taken steps over the course of 2014 to clarify and reassure multinational companies that they have access to legal representation in proceedings under the AML. For example, in an interview in May 2014, the Director General of NDRC's antitrust department said that internationally well-known lawyers were welcome to be involved in the ongoing Qualcomm investigation.[21] Most recently, the Chinese delegation to the JCCT formally reiterated a party's formal right to external counsel during an investigation, recognizing that the authorities allow lawyers to accompany their clients in meetings and proceedings.[22] In addition, they have indicated that representatives of foreign law firms in China may even be permitted to attend to advise on international law and practice. These commitments represent a significant step forward in giving transparency to enforcement proceedings. They should be reflected more explicitly in the relevant rules to give parties further confidence in the enforcement process.

Another area of sensitivity affecting international standards for effective representation is the protection of legal privilege for external legal advisors. Currently the concept of legal privilege is not recognized in China more broadly. Unlike in most established jurisdictions, therefore, this essentially means client-attorney communications may be discoverable by the authorities. While a full concept of legal privilege would be difficult to introduce, a public commitment consistent with international best practices to respect external legal advice that would be privileged in other jurisdictions would give significant comfort to the international community.[23]

C. Review and Accountability

Another important aspect of procedural fairness under international standards is a clear mechanism for review of enforcement decisions and accountability of the relevant authorities. The AML formally allows parties to seek reconsideration or bring an administrative litigation to

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[20] *See*, e.g., US-China Business Council, Competition Policy and Enforcement in China (Sept. 2014), *available at* https://www.uschina.org/reports/competition-policy-and-enforcement-china ("In [some] cases, companies have been pressured to omit legal counsel from the process to help the process 'run more smoothly.' Such practices […] are out of line with international best practices.").

[21] Interview with DG Xu Kunlin on Price Regulation and Antitrust, *Price Supervision and Anti-Monopoly in China*, 7 (July 2014).

[22] U.S. Fact Sheet: 25th U.S.-China Joint Commission on Commerce and Trade, *available at* http://www.ustr.gov/about-us/press-office/fact-sheets/2014/December/US-FACT-SHEET-25th-US-China-Joint-Commission-on-Commerce-and-Trade.

[23] Privilege protections vary significantly across jurisdictions. As a start, the authorities may limit the scope of information subject to the protection of legal privilege to communications that "are made for the purpose and interest of the exercise of the client's rights of defence in competition proceedings and that they emanate from independent lawyers." European Commission Notice on Best Practices for the Conduct of Proceedings Concerning Articles 101 and 102 TFEU, ¶16. *See* also International Competition Network, Anti-Cartel Enforcement Manual: Digital Evidence Gathering, §8.3, *available at* http://www.internationalcompetitionnetwork.org/working-groups/current/cartel/manual.aspx.

challenge a decision.[24] Targets of investigations may be reluctant to seek review due to concerns about reprisals or retaliation based on the broad authority of the relevant authorities outside of AML enforcement.[25] While such concerns may be unfounded, further measures would be helpful to allay the concerns of the international business community.

Successful efforts to seek administrative or judicial review of a decision are rare and not widely publicized. In the only known decision on an administrative litigation to challenge an enforcement decision, a case brought by three concrete companies seeking to overturn a price-fixing penalty by the local price bureau was dismissed for failure to comply with the relevant three-month statute of limitations. Other judicial challenges have reportedly been withdrawn before a final decision.

In recent statements, the Chinese authorities have sought to allay international concerns by committing to strictly follow formal procedures and notify parties of their rights under the AML.[26] Overall, these procedural protections can only be ensured if companies become more confident in seeking administrative or judicial review. Confidence can only be developed over time as the fairness of these procedures is demonstrated publicly.

D. Enforcement Transparency

Finally, decisions should not only provide solid reasoning for the parties subject to penalties. They should also provide valuable predictability to other businesses.[27] While the Chinese authorities historically have not publicly revealed much about their enforcement practices and the reasoning of their enforcement decisions, this is an area that has seen significant improvements over the past year. Until recently, NDRC only provided at most a very brief press release announcing its decision to impose penalties. However, in an effort to increase transparency, in September 2014 NDRC published full decisions for the first time, specifically in the Japanese auto parts and bearings cartel cases. It also published the full text of decisions in two additional cases closed at the end of 2013. Similarly, SAIC did not release any decisions in its first

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[24] Article 53 of the AML states: "In case of dissatisfaction with the decisions taken by the Anti-Monopoly Enforcement Authority pursuant to Articles 28 and 29, administrative reconsideration may be applied for. In case of dissatisfaction with the administrative reconsideration decision, they may initiate administrative litigation in accordance with the law."

[25] *See*, e.g., U.S. Chamber of Commerce, *Competing Interests in China's Competition Law Enforcement* (Aug. 2014), *available at* https://www.uschamber.com/report/competing-interests-chinas-competition-law-enforcement-chinas-anti-monopoly-law-application ("Once NDRC issues a determination or a penalty, firms technically have the legal right to appeal either administratively […] or judicially. However, firms are generally reluctant to appeal, […] or because they fear retribution for appealing NDRC determination, given NDRC's broad regulatory powers over investment projects and the economy as a whole.").

[26] Press Conference on Antitrust Enforcement Work Organised by the State Council State Council Information Office, *available at* http://www.scio.gov.cn/xwfbh/xwbfbh/wqfbh/2014/20140911/.

[27] FTC Chairwoman Edith Ramirez, Speech, *Core Competition Agency Principles: Lessons Learned at the FTC* (Beijing, May 22, 2014), *available at* http://www.ftc.gov/public-statements/2014/05/core-competition-agency-principles-lessons-learned-ftc-keynote-address ("Transparent and predictable decisions provide parties with guidance, facilitating their ability to determine in advance whether their actual or proposed conduct may violate the antitrust laws." Furthermore, "predictable, and transparent processes bolster the legitimacy of the enforcement outcome [and are] essential to maintaining the agency's credibility with its important stakeholders.").

three years of enforcement. Since 2013, however, SAIC has apparently published all of its current and historical AML decisions with increasing levels of detail.

However, decisions still may not include a detailed analysis of the relevant facts or the application of the law. Businesses may therefore lack clarity on how the AML has been applied in practice and have ongoing uncertainty in assessing compliance risks. For example, NDRC's previous decisions do not provide clarity into the mechanics of NDRC's assessment of the legal standards for RPM cases. While the press releases have suggested that some form of anticompetitive effect is required, they have not provided details on how the analysis should be applied. The decisions also have not provided extensive analysis of defenses presented by defendants, such as when conduct may be exempt under Article 15 of the AML.

While the enforcement authorities have made meaningful improvements in transparency in publishing these decisions, additional detail would be encouraged under international best practices. In particular, multinational companies seeking to assess the relevant compliance risks will be keen to understand the detail of enforcement decisions in ongoing cases involving abuse of dominance and IP licensing. Further transparency regarding enforcement practices and procedures would also help to clarify any misunderstandings and reinforce the enforcement authorities' compliance with international best practices. For example, the enforcement authorities could demonstrate that the parties had adequate opportunity to be heard on the merits of the investigation by providing a more detailed assessment of factual and legal defenses submitted by the parties.

V. LOOKING FORWARD

Overall, the Chinese enforcement authorities should be recognized for their receptiveness to external comments and willingness to promote measures to address international concerns about procedural fairness and transparency. Despite early questions about legal representation, the authorities have clearly established the right to external counsel, including the right to participation by foreign firms. The authorities have also taken significant steps to allow parties a more effective right to respond to the evidence against them and improve transparency on the substance and procedure of investigations.

While the commitment of the authorities cannot be doubted and further efforts can be expected, further measures to significantly support procedural rights and transparency are recommended. Given the short enforcement history in China, perceptions of the accountability of the enforcement authorities would also be supported over time by both further efforts of the parties to seek judicial review where they view potential concerns as well as by efforts by the courts to meaningfully address those concerns. However, expectations must be framed to a certain extent by the limits of the legal environment in China, including for example the lack of an established framework for recognizing legal privilege.