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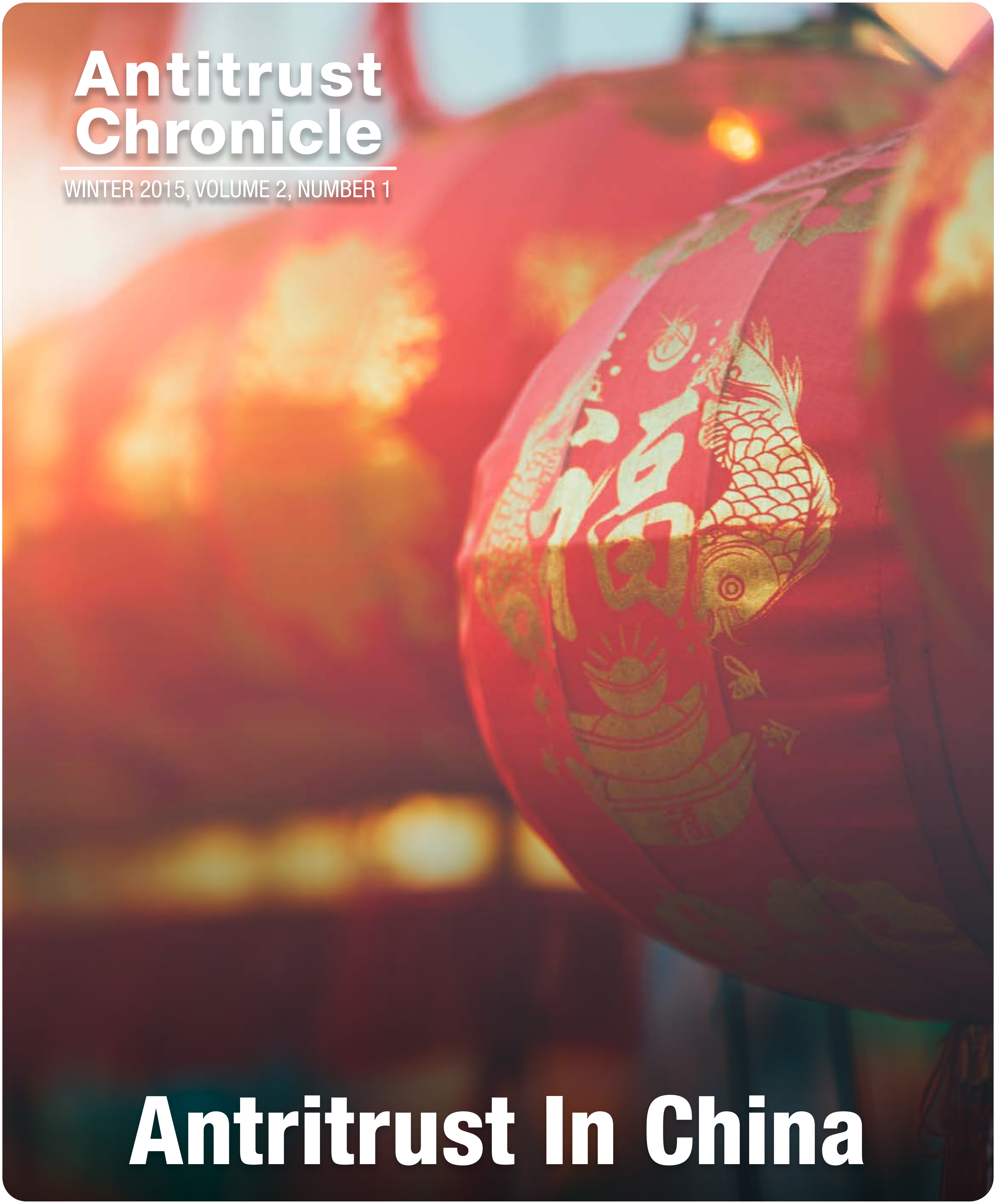

Antritrust In China

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The Impact of the Newly Revised Consumer Protection Law on Private Antitrust Enforcement in China

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The Impact of the Newly Revised Consumer Protection Law on Private Antitrust Enforcement in China

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I. INTRODUCTION

Celebrating its 20th anniversary, the Law on the Protection of Consumer Rights and Interests—which was promulgated in 1993 and took effect in 1994—was newly revised in 2013.[2] The revisions will take effect from March 15, 2014. (For easier reading, we will refer to the original and revised versions of the law as "1993 Consumer Protection Law" and "New Consumer Protection Law," respectively).[3] Compared to the 1993 Consumer Protection Law, the New Consumer Protection Law reflects the huge change in China's consumption patterns. The revisions aim at meeting the requirements of new trends in consumer protection.

In this revision, a large number of rules were amended or added. Substantial provisions involving the protection of personal information, the right to return goods bought online, and remedies against unfair contractual clauses have won extensive public praise. Procedural provisions related to mechanisms such as "public interest litigation," the reversal of the burden of proof, and punitive damages have also grabbed headlines, but are more controversial. To a great extent, these mechanisms differ from the existing general framework for civil litigation.

Similar to the United States, in China companies have begun using the Anti-Monopoly Law ("AML")[4] to resolve commercial disputes. This trend has accelerated since the entry into force of the Provisions on Several Issues concerning the Application of the Law in the Trial of Civil Dispute Cases Arising from Monopolistic Conduct ("Judicial Interpretation") by the Supreme People's Court on June 1, 2011.[5] However, there are no procedural stimulations such as class actions and triple damages as in the United States, and private enforcement of antitrust law in China has not been very active so far.

This article will place particular emphasis on the procedural provisions newly revised for consumer protection, since they not only have a great impact on civil litigation in relation to consumer protection, but also on private antitrust enforcement.

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[2] *Decision of the Standing Committee of the National People's Congress on Amending the Law of the People's Republic of China on the Protection of Consumer Rights and Interests,* adopted at the 5th Session of the Standing Committee of the 12th National People's Congress of the People's Republic of China on October 25, 2013.

[3] Law of the People's Republic of China on the Protection of Consumer Rights and Interests, [2013] Presidential Order No. 7, October, 25, 2013.

[4] Anti-Monopoly Law of the People's Republic of China, [2007] Presidential Order No. 68, August 30, 2007.

[5] Provisions by the Supreme People's Court on Several Issues concerning the Application of the Law in the Trial of Civil Dispute Cases Arising from Monopolistic Conduct, [2012] Judicial Interpretation No. 5.

II. LEGAL FRAMEWORK FOR PUBLIC INTEREST LITIGATION

In China, only those who are directly related to a dispute are entitled to bring a civil action to the court and become the subject of litigation. The existing legal framework does not have a mechanism similar to class actions in the United States, and China's private litigation has remained relatively underdeveloped for a long time. This situation began to change in 2012, when the Civil Litigation Law was revised ("New Civil Litigation Law").[6] The amended law took effect on January 1, 2013. Article 55 of New Civil Litigation Law features a breakthrough relative to the prior framework, which required plaintiffs to be "directly related to" the dispute to have standing:

> Relevant bodies and organizations prescribed by law may bring a suit to the people's court against such conduct as environmental pollution, harm of the consumer's legitimate interests and rights and other conduct that undermines the social and public interest.[7]

It is generally believed that this provision establishes the "public interest litigation" mechanism in China. However, it is equally clear that the implementation of this provision in the New Civil Litigation Law needs other laws or rules to specify which the "relevant bodies and organizations prescribed by law" are. Actually, the New Consumer Protection Law is one of these corresponding laws. In Article 47, it provides that

> the China Consumers Association and the consumer associations established in all provinces, autonomous regions and municipalities may bring lawsuits to the people's courts against activities detrimental to the legitimate rights and interests of a large number of consumers.

According to our reading of the above two provisions, "public interest litigation" under the New Consumer Protection Law refers to the following situation: If a large number of consumers are or may be harmed, and the specific number of the consumers is uncertain, then a consumers association unrelated to the dispute has the right to bring a suit before court in its own name, in order to protect the public interest.

Public interest litigation has two characteristics: first, the consumers association is entitled to act as a plaintiff in its own name; second, consumers that were directly harmed by the wrongful conduct are allowed to join the suit brought by the consumer association for free. Therefore, the condition in the prior civil litigation rules—that only those directly related to the case had standing as a plaintiff—has changed.

Until now, no law or regulation explicitly provides that anticompetitive conduct falls within the scope of "other conduct that undermines the social and public interest" under Article 55 of the New Civil Litigation Law. However, many observers believe that anticompetitive conduct is, in many aspects, similar to conduct such as environmental pollution, and harms consumers' rights and interests. Anticompetitive conduct can have a significantly negative impact upon social and public interests, and the victims often do not obtain effective redress or

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[6] *The Decision of the Standing Committee of the National People's Congress on Revising the Civil Litigation Law of the People's Republic of China*, adopted at the 28th Session of the Standing Committee of the 11th National People's Congress on August 31, 2012

[7] Civil Litigation Law of the People's Republic of China, [2012], Presidential Order No. 59, August 31, 2013.

sufficient compensation (winning, if anything, relatively low-value damages amounts). Victims are usually unwilling to bring an individual lawsuit to request compensation for damages. In some circumstances, where a large number of individual lawsuits are brought for the same infringement, procedural efficiency can be impeded if these lawsuits cannot be joined.

Thus, representative actions by consumers associations under the New Consumer Protection Law represent a landmark event, including a possibility for private antitrust litigation. It is possible that the first "public interest litigation" suits by a consumers association targeting anticompetitive conduct will be brought in the near future after the New Consumer Protection Law takes effect on March 15, 2014.

III. ENCOURAGING PRIVATE ANTITRUST ACTIONS THROUGH "PUBLIC INTEREST LITIGATION"

The AML only has one provision referring to civil litigation, and this provision (Article 50) is at a very high level.[8] The Supreme People's Court had tried to include a provision to encourage private actions in the Judicial Interpretation. A draft provision of the Judicial Interpretation was similar to that in the New Consumer Protection Law. That is, the draft provision would have empowered a consumers association to bring an action on behalf of a group of consumers.

However, the draft provision was not enacted, likely because the Supreme People's Court thought that such a ground-breaking change of the prevalent civil litigation framework could not be done through a comparatively low level legislative text such as a Judicial Interpretation. There is no doubt, however, that the National People's Congress has enough authority to make such a change through the revision of two laws—the Civil Litigation Law in 2012 and the Consumer Protection Law in 2013.

A. Encouraging Class Actions

Private antitrust enforcement in China is far behind that of developed jurisdictions. The lack of modern class actions is one of the main reasons. In the United States, around 20 percent of the private antitrust suits are class actions, which is one of the most important reasons why the United States is perceived to have a leading position in the area of private antitrust enforcement.

As for the European Union, it does not have a long tradition of private enforcement in the antitrust area. However, the European Commission is striving to change the situation. Its White Paper on damages actions for antitrust violations published in April 2008 explains that the underlying issue the European Commission seeks to address is that individual consumers are often deterred from bringing an individual action for damages as a result of the costs, delays, uncertainties, risks, and burdens involved. The outcome is that victims often fail to obtain adequate compensation in the case of antitrust violations.

Hence, in its White Paper, the European Commission proposes a combination of two complementary mechanisms for collective redress: (1) representative actions, which are brought by qualified entities such as consumers associations, state bodies, or trade associations on behalf

[8] Article 50 of the AML stipulates, "if business operators implement monopolistic conduct and cause loss to others, the business operators shall be responsible for civil liabilities in accordance with the law."

of victims; and (2) opt-in collective actions, in which victims expressly decide to combine their individual claims into one single action.[9]

Compared with the U.S. and EU practices, private enforcement of antitrust law in China is still in its infant stage. It should be noted that, in most of the cases brought by individuals, the plaintiff is just one of a large number of consumers. Generally, the plaintiffs claim a relatively small amount of damages. For instance, in *Li Fangping v. China Netcom*, Li Fangping, the plaintiff, brought the action in his own name against the defendant, a fixed-line telephone service provider in Beijing. The plaintiff argued that China Netcom had abused its dominant market position. In particular, Mr. Li alleged that the defendant conducted discriminatory treatment to his detriment. The alleged discrimination was between him, as a China Netcom customer without a registered residence (*hukou*) in Beijing, and those customers with registered residences in Beijing. Only the latter were able to sign a post-paid contract with China Netcom according to the company's policy. It is noteworthy that Mr. Li asked for just RMB 1 in damages.

In *Li Fangping v. China Netcom*, the plaintiff's claims were dismissed by the Beijing Intermediate People's Court at first instance and the Beijing High People's Court on appeal.[10] It is not hard to imagine that the courts would be overburdened, and judicial resources wasted, if all consumers without a registered residence in Beijing brought actions against the same defendant.

Indeed, there are some similar cases where the victims may be numerous. In August 2008, for example, Liu Fangrong brought an action against the Chongqing Insurance Association for insurance loss of RMB 1, alleging that the defendant had implemented a cartel.[11] Similarly, in April 2009, in *Zhou Ze v. China Mobile*, the plaintiff asked the court to issue an injunction to stop the defendant from abusing its market dominance by collecting monthly rental fees. The compensation the plaintiff claimed in that case was the refund of RMB600-worth of paid monthly rental fees.[12]

None of the above-mentioned cases was finally adjudicated in favor of the plaintiffs. Part of the reason is the conduct challenged may actually be in line with the antitrust laws. But it is also possible that the individual consumers lost the lawsuits because they were simply not able to discharge the burden of proof. Moreover, it is possible that the courts took into consideration that, should the plaintiffs win the case, a large number of actions might be brought by victims who were in conditions similar to the plaintiffs. In any event, the series of judgments against the consumer-plaintiffs definitely discouraged victims of antitrust violations from coming forward.

It seems that class actions are one of the best ways to address the issues facing private antitrust litigation in China. Article 54 of the New Civil Litigation Law allows "representative

[9] European Commission, White Paper on Damages Actions for Breach of the EC Antitrust Rules, COM(2008)165, final, sec.2.1.

[10] Beijing Intermediate People's Court No. 2, *Li Fangping v China Netcom (Group) Co. Ltd. Beijing Branch*, December 18, 2009, [2008] Er Zhong Min Chu Zi No. 17385; and Beijing High People's Court, *Li Fangping v China Netcom (Group) Co. Ltd. Beijing Branch*, June 9, 2010, [2010] Gao Min Zhong Zi No. 481.

[11] *See* Sina Finance,*Chongqing Insurance Association is Accused of Monopoly*, August 17, 2008, *available at* http://finance.sina.com.cn/china/dfjj/20080817/13325207533.shtml (last visited on January 20, 2014).

[12] *See* Money 163, *China Mobile's Monthly Rent Collection is Suspected of Monopoly*, October 28, 2009, *available at* http://money.163.com/09/1028/00/5MM23EJF002526O3.html(last visited on January 20, 2014).

actions" where a large yet uncertain number of persons have standing at the commencement of the action. The representative action is a type of class action that, however, is subject to the traditional restriction: the representative must be directly related to the dispute. So, although the representative action is able to solve the procedural inefficiency caused by the multiplicity of actions brought by a large number of individual consumers for the same antitrust infringement, the requirement that the representative be directly involved in the dispute reduces the effectiveness of the new procedural tool. In particular, as pointed out in the European Commission's White Paper on damages actions for breaches of antitrust rules, individual consumers may be deterred from filing an action for damages because of the costs, delays, uncertainties, risks and burdens involved.

Further, in practice, courts have taken an extremely cautious attitude towards representative actions involving an uncertain number of persons. We are not aware of any successful representative action yet, even outside the antitrust field.

Unlike representative actions involving an uncertain number of litigations, which are a kind of class action brought by consumers, "public interest litigation" is a kind of class action brought by consumers associations. A key difference is that these associations are generally not directly related to the specific dispute. Since the litigation is initiated by consumers associations, individual consumers might be compensated for their loss—which might be relatively small and not worth an individual action—without excessive costs and risks.

Thus, if a consumers association can bring an action as a plaintiff in its own name, individual consumers are more likely to get involved in a private antitrust litigation and are able to focus on more substantial issues such as evidence collection. In addition, more individual consumers may get involved in "public interest litigation "as such cases are more likely to be adjudicated in favor of the plaintiffs. If so, this may create a virtuous circle that promotes the development of class actions in the antitrust field.

B. Connecting Private and Public Antitrust Enforcement

China's public enforcement of antitrust rules has achieved significant progress since the AML's entry into force. Both the National Development and Reform Commission ("NDRC")—the authority responsible for investigating and sanctioning price-related anticompetitive conduct—and the State Administration for Industry and Commerce ("SAIC")—the authority in charge of handling enforcement against anticompetitive conduct not related to pricing—accelerated their public enforcement during 2013. In particular, for actions against price-related conduct, NDRC investigated and punished industries such as LCD panels, high-end liquors, infant formulas, gold, and jewelry, imposing fines reaching the billions of RMB. As for actions against non-price related conduct, SAIC investigated about 30 cases and 13 of them have been announced publicly and formal decisions have been adopted.

These antitrust cases—especially those investigated by NDRC—usually have a strong impact on consumers and thus attract a great deal of attention from the public. The *Moutai* and *Wuliangye* cases are good illustrations. As a provider of one of the most famous high-end liquors loved by millions of consumers in China, Moutai was exposed in early January of 2013 as having warned its distributors against their practice of lowering resale prices below the level fixed by Moutai. With an aim to maintain its high-level retail prices, Moutai threatened to penalize those distributors who violated its resale price maintenance ("RPM") policy. As a result, Moutai suspended its contracts with some distributors, and parts of the distributors' deposits were withheld. Similar to Moutai, Wuliangye—another high-end white liquor producer—was reported to have punished its distributors for violating its RPM policy.

Since RPM is mentioned as an illegal vertical agreement in the AML, the two companies' conduct triggered investigations by NDRC. On February 22, 2013, NDRC authorized its provincial branches in Guizhou to impose a fine of RMB 247 million on Moutai. On the same day, Wuliangye was imposed a fine of RMB 202 million by NDRC's Sichuan branch. Both the official media and the public at large expressed their support for NDRC's action in the *Moutai* and *Wuliangye* cases. The media and public were particularly supportive as the two companies are state-owned enterprises, and few law enforcement authorities in China "dare" punish state-owned enterprises.

However, although Moutai and Wuliangye have been sanctioned by NDRC in public decisions, no individual consumer has tried to bring a "follow-on" action—based on NDRC's public decision—to seek compensation for damages suffered. There are a large number of consumers who had suffered as a result of the anticompetitive conduct of Moutai and Wuliangye, by paying the overcharged retail price for their liquor.

From this case it can be seen that China lacks mechanisms that function as bridge to connect public with private antitrust enforcement. The same issue can be found in NDRC's decisions in the *LCD panels* case (RPM), *Baby milk formula* case (RPM), and *Gold and jewelry* case (cartel), all made public during 2013.

"Public interest litigation" brought by consumers associations under the New Consumer Protection Law have the potential to function as a bridge between public and private enforcement. Let us still take the *Moutai* case as an example. After Moutai was punished by NDRC, the New Consumer Protection Law would allow those consumers who believed they were harmed to request a consumers association—say, the China Consumers Association—to bring an antitrust suit against Moutai. Of course, the China Consumers Association could also launch an action against Moutai on its own initiative. Since the China Consumers Association can, in its own name, represent all consumers having suffered from the RPM conduct of Moutai, consumers who could show to have suffered harm could expressly decide to combine their individual claims into the "public interest litigation."

Since the victims who suffered from Moutai's anticompetitive behavior are numerous, and their loss is relatively small, joining their claims through "public interest litigation" is the best way to establish a platform to win the suit against the perpetrator, in this case Moutai. For example, even though Moutai's anticompetitive practice has been identified, it is still hard for an individual consumer to prove the specific amount of loss.

There is another situation where public and private enforcement could be connected—i.e., after a consumers association wins a "public interest litigation" case against a company infringing antitrust rules, an antitrust authority could follow up with an administrative investigation. An example of this scenario is the *Huawei v. InterDigital* case. In mid-2013, the Guangdong High People's Court rendered its judgment in that case. Shortly after, NDRC was reported to be investigating InterDigital for alleged abuse of dominance for the way it had exercised some of its standard-essential patents.

In short, "public interest litigation" could work as a bridge to connect public and private antitrust enforcement since it is one of the best tools to bring together harmed consumers and allow them to join forces to overcome cost and risk challenges.

IV. OTHER PROCEDURAL ISSUES

"Public interest litigation" aside, the New Consumer Protection Law has brought some other revisions that are believed will influence private antitrust enforcement in China.

A. Reversal of the Burden of Proof

According to the applicable legal framework in general civil litigation, the primary principle for the burden of proof is "he who is affirming must prove." The allocation of the burden of proof plays a key role in practice. Even if a plaintiff's claims are legitimate on the substance, the action will only be successful if the pertinent evidence is collected. If the burden of proof is too high or too costly, then the justice system does not work properly.

Compared to the 1993 Consumer Protection Law, the New Consumer Protection Law strengthens the obligation of businesses. Among all the measures taken in the new law, the reversal of the burden of proof in relation to certain issues is one of the sharpest weapons for consumers. This measure addresses the problem of the high burden of proof and high cost for a consumer to claim his or her rights.

In contrast with the 1993 Consumer Protection Law, a new paragraph was added to Article 23 of the New Consumer Protection Law. Article 23(3) now reads:

> where disputes arise because consumers find defects in the motor vehicles, computers, television sets, refrigerators, air conditioners, washing machines and other durables, or decoration or furnishing services provided by business operators within six months upon accepting such products or services, the business operators shall bear the burden of proof regarding the defects.

This newly added paragraph reverses the burden of proof regarding defects in products or services such as durables or decoration services. It will have a significant impact on the trial of disputes in respect of consumer rights, and will increase the probability that cases are adjudicated in favor of consumers. As is well known, proving the existence of product defects often involves specialized knowledge and is often a difficult and costly task. However, according to the New Consumer Protection Law, it is the business operators—rather than the consumers—that now bear the burden of proof pertaining to whether the product has defects. If the business operators cannot submit sufficient evidence to prove that the product has no defects, they will have failed to discharge their burden of proof and must bear the adverse consequences. The courts then would find the products involved as defective, and further find that the business operators should bear civil liability towards consumers.

The reversal of the burden of proof, as provided in Article 23 of the New Consumer Protection Law, might also have an impact on private enforcement of antitrust law in China. Since there are no laws or regulations that explicitly explain the concept of "durables," it is quite likely that companies held to violate antitrust rules also produce or sell durables. For example, on

January 4, 2013, NDRC imposed a fine of RMB 353 million on six LCD panel producers from Korea and Taiwan for price-fixing. During 2001-2006, the six LCD panel producers had convened 53 times in so-called "crystal meetings" to exchange competitively sensitive information on LCD panels and to fix prices. Since LCD panels might also be regarded as durables, Article 23(3) of the New Consumer Protection Law might be applicable and found to infringe antitrust rules.

B. Punitive Damages

According to the traditional theory on compensation for damages, the best principle is that of full compensation, which means that the scope of damages should only be based on the actual property losses caused by the illegal act.

However, in China, under certain circumstances, some laws and regulations allow for punitive damages. As such, Article 55 of the New Consumer Protection Law involves punitive damages in the case of fraudulent activity and product liability. It reads:

> Unless otherwise prescribed by law, business operators that practice fraud in providing products or services shall, on the demand of consumers, increase the compensation for their losses by an amount that is three times the payment made by the consumers for the products purchased or services received, or in the amount of RMB 500 if the increased compensation is less than RMB 500.
>
> Where business operators knowingly provide defective products or services for consumers, causing the death of, or serious health damage to, the consumers or other victims, the victims shall be entitled to demand the business operators to compensate for the losses in accordance with Article 49 and Article 51 of this law and other legal provisions, and to demand punitive damages of up to twice the losses suffered.

Accordingly, whether or not a consumer can claim triple damages in a private antitrust action depends on how the courts would interpret the concept of "fraud." The Supreme People's Court is expected to promulgate a judicial interpretation to give guidance on the implementation of the New Consumer Protection Law. Hopefully, an interpretation of the definition of "fraud" will be included in the judicial interpretation. This guidance may explain if, and how, the courts will be empowered to award punitive damages in private antitrust actions.

V. CONCLUSION

The New Consumer Protection Law, which will come into effect on March 15, 2014, is expected to have significant impact on private antitrust enforcement in China.

The "public interest litigation" provision in the amended law is likely to encourage consumers and /or consumer associations to bring more court actions based on allegations of monopolistic behavior. This legislative change may possibly lead to quasi-class actions in China, which will make private enforcement a comparatively powerful weapon against anticompetitive conduct. In addition, some procedural provisions in the New Consumer Protection Law—such as the reversal of the burden of proof and punitive damages—will likely also shape the future of private antitrust litigation in China.

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Determining the FRAND Rate: U.S. Perspectives on *Huawei v. InterDigital*

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Determining the FRAND Rate: U.S. Perspectives on *Huawei v. InterDigital*

Fei DENG and Su SUN[1]

I. INTRODUCTION

Standards have become part of our life in this world of rapid technological progress. Antitrust policy makers and practitioners have long realized the important benefits standards bring to social welfare: higher product quality and lower costs for manufacturers that result from the widespread adoption of advanced technologies and the benefits from network externalities and scale economies. However, in recent years, developments in technology licensing involving standard essential patents ("SEPs") have drawn many into heated discussions as to whether owners of SEPs who, as members of the relevant standard-setting organization, promised to license their SEPs on fair, reasonable, and non-discriminatory ("FRAND" or "RAND") terms may have abused the market power they possess simply by virtue of their technologies being included in the standard, and whether the rates they seek are inconsistent with their FRAND obligations.

Antitrust enforcement agencies in the United States and in the European Union have shown great concern over licensing practices of SEP owners with FRAND obligations. A general consensus seems to have emerged that SEP owners should be limited by their FRAND commitments, and that seeking injunctions against willing licensees may be considered an antitrust violation.[2] In several cases, putative licensees have requested that a court determine the FRAND rate and assess whether the SEP owner behaved inconsistently with its FRAND obligations.

As the world economy has become increasingly integrated, and intellectual property rights are more strongly enforced in jurisdictions around the world, global technology licensing has become more common. Inevitably, disputes regarding royalty rates and other terms in patent licensing are rising quickly. Although the United States and the European Union remain the major jurisdictions where licensing disputes are adjudicated, other jurisdictions are emerging as new potential forums for parties to consider strategically. For example, the patent war between Apple and Samsung has reached the courts in South Korea,[3] and the Competition Commission of

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[2] *See* Jonathan Kanter, *What a Difference a Year Makes: An Emerging Consensus on the Treatment of Standard Essential Patents*, 10(2) CPI ANTITRUST CHRON. (October, 2013).

[3] *See South Korea Court Says Samsung, Apple Infringed Each Other's Patents* (August 24, 2012), *available at* http://online.wsj.com/news/articles/SB10000872396390444812704577608242792921450?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB10000872396390444812704577608242792921450.html.

India is investigating Ericsson for allegedly charging Indian companies high royalty rates that violated the company's FRAND commitments.[4]

But perhaps the most significant emerging jurisdiction for SEP and FRAND disputes is China. On February 4, 2013, the Shenzhen Intermediate People's Court in Guangdong province in China issued a decision that determined a FRAND rate for InterDigital's SEPs in *Huawei v. InterDigital*, several months before a U.S. court ruled on FRAND rates for the first time in *Microsoft v. Motorola*.[5]

II. SEP AND FRAND IN CHINA

FRAND increasingly has been the focus of attention in China in recent years, for at least three reasons:

First, China's further integration into the world economy has led to an increasing need for Chinese companies to license patents, both in China and outside China, from multinational companies. This is particularly true in the area of computers and wireless communications. Chinese companies such as Lenovo and Huawei have become significant suppliers of computers and mobile devices, where the products inevitably utilize technologies specified in established standards that are covered by patents.

Second, China has been promoting the development of an innovation-based economy. To achieve this goal, the Chinese government has issued policies that encourage the development of indigenous patents and industry standards.[6] As part of this process, the Chinese government is well aware of the potential abuse of SEPs. For example, China has recently promulgated the Regulation on the Administration of National Standards Involving Patents. According to this regulation, both full disclosure and a FRAND commitment on the included patents from standard-setting participants are required prior to the issuance of a standard.[7]

Third, after more than five years of enforcement of China's Anti-Monopoly Law ("AML"), both antitrust enforcement agencies and courts in China have become more confident in pursuing more difficult antitrust issues such as violation of FRAND obligations. The Ministry of Commerce ("MOFCOM"), China's antitrust agency in charge of merger review, has reviewed hundreds of merger filings, including some that involved significant patent issues, and some of its conditional approvals have included remedies involving divestiture or licensing of patents.[8]

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[4] *See India Widens Ericsson Royalties Probe* (January 20, 2014), *available at* http://online.wsj.com/news/articles/SB10001424052702304027204579332063867181726.

[5] *Microsoft Corp.* v. *Motorola, Inc.*, No. C10-1823, 2013 WL 2111217 (W.D. Wash. Apr. 25, 2013) (Robart, J.).

[6] *See*, for example, *State Council Notice on the Issuance of the Plan to Foster Indigenous Innovation Capability During the Twelfth Five Year Plan*, *available at* http://www.gov.cn/zwgk/2013-05/29/content_2414100.htm.

[7] The State Standardization Administration and the State Intellectual Property Office's Public Notice on the Promulgation of the Provisional Regulation on the Administration of National Standards Involving Patents (December 19, 2013), *available at* http://www.sipo.gov.cn/zcfg/flfg/zl/bmgfxwj/201401/t20140103_894910.html.

[8] For a comprehensive summary of MOFCOM merger decisions, *see* Fei Deng & Cunzhen Huang, *A Five Year Review of Merger Enforcement in China*, 13(1) ANTITRUST SOURCE (October 2013). For a discussion of the role of IPR in MOFCOM's merger decisions, *see* Jing He, Su Sun, & Angela Zhang, *The Role of IPRs in China's Antitrust Merger Review*, INT'L ANTITRUST BULL. (March, 2012).

Most recently, there have been news reports about Chinese mobile device makers' efforts to lobby MOFCOM for antitrust intervention on Microsoft's acquisition of Nokia's mobile phone assets and related patent portfolio.[9] The concerns expressed in these news reports primarily focus on the merging parties' ability post-merger to raise royalty rates in licensing their wireless patents, including both SEPs and non-SEPs.

China's other two antitrust enforcement agencies have also increased their efforts in the intellectual property area. The State Administration for Industry and Commerce ("SAIC") has been drafting guidelines/regulations on antimonopoly enforcement in the intellectual property area, and the National Development and Reform Commission ("NDRC") has recently started investigations against InterDigital[10] and Qualcomm[11] on their royalty rates and licensing practices involving SEPs.

Although China's antitrust enforcement agencies have become active in SEP and FRAND issues, not much detail of their investigations has been revealed so far. Indeed, it is the judiciary that has shed the most light on how such issues may be treated in China—through the adjudication of the licensing disputes between InterDigital and Huawei.

III. A BRIEF HISTORY OF *HUAWEI V. INTERDIGITAL*

Huawei and InterDigital had negotiated on the terms for Huawei to license InterDigital's wireless communications patents both through emails and in-person meetings in Shenzhen, China, but could not reach an agreement. Subsequently, InterDigital filed lawsuits on July 26, 2011 at both the U.S. International Trade Commission ("ITC") and a U.S. district court against Huawei, among other companies, for allegedly infringing seven of its U.S. patents related to 3G technologies.[12]

Faced with InterDigital's litigation pressure in the United States, Huawei sued InterDigital on December 6, 2011 at the Shenzhen Intermediate People's Court in Guangdong province in China.[13] In one complaint, Huawei claimed that InterDigital abused its dominant position in licensing SEPs in the 3G wireless communications standard by imposing tying, discriminatory conditions, and other unreasonable conditions, as well as by initiating sudden lawsuits against Huawei in the United States. Huawei alleged that, in essence, such abusive acts were equivalent to a refusal to deal, and had harmed Huawei's operations and lessened competition in the market. Huawei sought injunctions against the alleged abusive conduct and damages of RMB 20 million (approximately $3.2 million). Separately, in the other complaint, Huawei alleged that InterDigital violated its FRAND commitments and asked the court to determine the appropriate FRAND rate.

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[9] *See* http://finance.sina.com.cn/chanjing/gsnews/20131220/231417705213.shtml.

[10] *See* http://www.reuters.com/article/2013/12/16/interdigital-china-idUSL3N0JV10020131216.

[11] *See* http://www.bloomberg.com/news/2013-11-25/qualcomm-says-china-agency-started-anti-monopoly-law-probe.html.

[12] InterDigital 2012 10-K, *available at* http://www.sec.gov/Archives/edgar/data/1405495/000140549513000010/idcc-20121231x10k.htm#sB8CBDEB8939B47C8E810BD0438747BFA, pp. 32-33.

[13] Huawei also filed a complaint with the European Commission on May 23, 2012. *See* InterDigital 2012 10-K, p. 74.

After InterDigital's failed attempt to change the venue out of Shenzhen,[14] where Huawei's headquarters are located, the Shenzhen Intermediate People's Court issued two decisions on February 4, 2013 in both proceedings. The full text of the decisions is not yet publicly available. However, the three judges who decided the case published an article providing an overall description of some relevant issues and the reasoning behind their decisions.[15]

The Shenzhen court sided with Huawei, and determined that InterDigital violated its FRAND commitments and abused its market power in its licensing practices. The court ordered InterDigital to cease the alleged excessive pricing and alleged improper bundling of InterDigital's Chinese essential and non-essential patents, and to pay Huawei RMB 20 million in damages. The court also ruled that the royalties to be paid by Huawei for InterDigital's 2G, 3G, and 4G essential Chinese patents should not exceed 0.019 percent of the actual sales price of each Huawei product.[16] Soon after the Shenzhen court's decision, InterDigital appealed, but the Guangdong High People's Court affirmed the Shenzhen court's decisions on October 28, 2013.

On the U.S. side, InterDigital filed another round of complaints on January 2, 2013 at both the ITC and U.S. district court against Samsung, Nokia, Huawei, and ZTE, for allegedly infringing seven of its U.S. patents related to 3G and 4G technologies.[17] On June 28, 2013, the ITC's Administrative Law Judge ("ALJ") issued a finding that InterDigital's asserted patents were not infringed and thus Huawei (and Nokia and ZTE) did not violate Section 337. On December 19, 2013, the ITC affirmed the ALJ's finding.[18]

On January 2, 2014, InterDigital and Huawei reached a settlement agreement, ending their global patent litigation and pledging to resolve their disputes through arbitration.[19]

IV. METHODOLOGIES OF FRAND RATE DETERMINATION APPLIED TO *HUAWEI V. INTERDIGITAL*

The China part of the *Huawei v. InterDigital* litigation touches upon a wide range of important issues in both antitrust and intellectual property law, including market definition in technology licensing involving SEPs and patent infringement assertions by non-practicing entities ("NPEs").[20] Perhaps the most interesting issue covered in this case is the determination of the FRAND rate, which we will focus on in the discussions below.

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[14] [2012] Yue Gao Fa Li Min Zhong Zi No. 160, *available at* http://www.gdcourts.gov.cn/gdcourt/front/front!content.action?lmdm=LM41&gjid=20121010090340884597.

[15] Ye Ruosi, Zhu Jianjun, & Chen Wenquan, *Determination of Whether Abuse of Dominance by Standard Essential Patent Owners Constitutes Monopoly: Comments on the Antitrust Lawsuit Huawei v. InterDigital*, Electronic Intellectual Property Rights No. 3 (2013) (hereinafter, "Ye 2013").

[16] InterDigital 2012 10-K, p. 75.

[17] InterDigital 2012 10-K, p. 21.

[18] *See* http://www.usitc.gov/secretary/fed_reg_notices/337/337_800_notice12192013sgl.pdf.

[19] Huawei also agreed to end its antitrust complaints. *See* http://www.worldipreview.com/news/interdigital-settles-with-huawei.

[20] For a general discussion of important issues covered in *Huawei v. InterDigital*, *see* Michael Han & Kexin Li, *Huawei v. InterDigital: China at the Crossroads of Antitrust and Intellectual Property, Competition and Innovation*, 11(2) CPI ANTITRUST CHRON. (November 28, 2013).

A. General Framework for FRAND Rate Determination

The legal standard for determining a "reasonable royalty" in U.S. case law is framed by the fifteen Georgia-Pacific Factors articulated in a district court decision on a patent infringement case in 1970.[21] The first two U.S. cases in which courts determined FRAND rates—*Microsoft v. Motorola*[22] and *In re Innovatio*[23]—both considered the Georgia-Pacific factors. But, these two cases also focused on three additional key considerations that arise in a FRAND context. First, the FRAND rate should not include the hold-up value that is a result simply of the patents being included in a standard. Second, the FRAND rate should avoid royalty stacking because cumulative royalty payment to all SEP holders can quickly become excessive and suppress adoption of the standard. Third, the FRAND rate for SEPs should be set high enough to provide incentives for the patent owners to participate in the standard-setting process.

To take these considerations into account, these two U.S. decisions provided a general methodology for determining FRAND rates in a hypothetical bilateral negotiation before the technologies covered by the plaintiff's patent portfolio were included in the standard. The two decisions also provided a roadmap for calculating FRAND rates: first, consider how important the patent portfolio is to the standard; second, consider how important the patent portfolio is to the alleged infringer's products; and third, consider potentially "comparable" licenses as a benchmark for the FRAND rate.

It appears that InterDigital's FRAND obligation quoted by the Shenzhen court originated from its FRAND obligation under the European Telecommunications Standardisation Institute ("ETSI"), not under a Chinese standard-setting association. Also, it is not clear how many of the InterDigital patents offered to be licensed to Huawei are essential to the 2G, 3G, and 4G standards, and how important these patents are to Huawei's relevant products. This typically would require a comprehensive technical analysis. Nevertheless, we focus our analysis below on how the FRAND rate could have been determined using the methodologies that have been developed in the United States.

B. Determining FRAND Royalty Rates Using Comparable Licenses

The Shenzhen Intermediate People's Court ruled that the InterDigital offers did not comply with FRAND, and that the royalties to be paid by Huawei for InterDigital's 2G, 3G, and 4G essential Chinese patents should not exceed 0.019 percent of the actual sales price of each Huawei product, without explanation as to how it arrived at this calculation.[24] However, the three judges who ruled on this case wrote an article that provided more details on their reasoning, though the article did not touch on how the FRAND rate was calculated.[25] The judges' article states that:

> when comparing the terms of the offers that the defendant made to the plaintiff with the terms of the licenses that the defendant signed with Samsung, Apple, and

[21] *Georgia-Pacific Corp.* v. *US. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

[22] *Microsoft v. Motorola* involves the 802.11 WiFi standard and the H.264 video coding standard.

[23] *In re Innovatio IP Ventures, LLC, Patent Litigation*, No. 1:11-cv-09308 (N.D. Ill. Sept. 27, 2013) (Holderman, J.). This case involves 802.11 WiFi standard.

[24] InterDigital 2012 10-K, p. 43.

[25] Ye 2013, *supra* note 15.

> others, regardless of using the standard of one-time lump sum payment or per unit royalty rate, the rates stated in the offers are much higher than those in the licenses to Samsung, Apple, and others. The defendant not only demanded high royalty rates, but also forced the plaintiff to license all of its patents back for free, bringing extra benefits to the defendant. These indicate that the defendant's pricing was too high and discriminatory. Investigation shows that both the quality and the quantity of the patents owned by the plaintiff are much higher than those of the patents owned by the defendant. In other words, the market and technological value of the plaintiff's patents is much higher than that of the defendant's. In the mobile communications area, cross-licensing between owners of essential patents is not anti-competitive. But because the defendant does not manufacture any goods and the defendant's business model is licensing only, the defendant is enabled to receive extra benefits, which further exacerbates the high royalty rates in the defendant's offers. These indicate that the defendant has violated its FRAND commitment.[26]

One may infer from the statement above that the court used InterDigital's licenses with Samsung, Apple, and others as comparable licenses to determine whether the royalty rates InterDitigal offered to Huawei were discriminatory, and possibly also to calculate the appropriate FRAND royalty rate that should be charged to Huawei, which was determined to be no more than 0.019 percent.

One article commenting on the royalty rate determination in this case provided more information based on the redacted version of the unpublished decision, which the authors had access to:

> To determine the reasonableness of the finding of discrimination, the court examined publicly available information, including information on InterDigital's licensing revenues, to estimate the fees that InterDigital charged or proposed to charge Apple, Samsung and others. The court needed to reverse engineer these numbers because InterDigital refused to disclose them, fearing that they would be provided to non-parties to the case. The court then compared those estimates to the fees that InterDigital had demanded from Huawei and found the latter to be much higher. Based on the court's calculations, the rates InterDigital demanded from Huawei are close to one-hundred times the rates it charged Apple and ten times the rates it charged Samsung.[27]

According to InterDigital's 2012 10-K, InterDigital and Samsung entered into a patent license agreement in 2009, granting Samsung "a non-exclusive, worldwide, fixed-fee royalty-bearing license covering the sale of single-mode terminal units and infrastructure designed to operate in accordance with TDMA-based 2G standards that became paid-up in 2010 and a nonexclusive, worldwide, fixed-fee royalty-bearing license covering the sale of terminal units and infrastructure designed to operate in accordance with 3G standards through 2012."[28] Samsung paid InterDigital $400 million in four equal installments over an 18-month period, and the license ended all litigation and arbitration proceedings then ongoing between the parties.[29] The

[26] *See* Ye 2013, *supra* note 15 at 51.

[27] D. Daniel Sokol & Wentong Zheng, *FRAND in China*, working paper, Oct. 3, 2013, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2335664.

[28] InterDigital 2012 10-K, p. 11.

[29] *Id.*

3G portion of the license expired at the end of 2012, and Samsung was included as another defendant, together with Huawei, Nokia, and ZTE, in both the ITC action and the district court action filed by InterDigital on January 2, 2013.[30]

As for the InterDigital-Apple license, according to an InterDigital SEC filing the license was signed on September 6, 2007, and was "a worldwide, non-transferable, non-exclusive, fixed-fee royalty-bearing … seven-year license agreement, effective June 29, 2007." The agreement specified that "InterDigital granted a license to Apple under InterDigital's patent portfolio covering the current iPhone (TM) and certain future mobile phones, if any."[31] It appears that Apple paid a one-time payment of $20 million at the beginning, and an on-going quarterly $2 million fee for the next seven years.[32] It is not clear what standards the license agreement covers—whether all or part of 2G, 3G, or 4G standards are covered under this license agreement.

InterDigital describes itself as "a leading designer and developer of technology solutions and intellectual property for the wireless industry…[that] monetize[s] those solutions and intellectual property through a combination of licensing, sales and other revenue opportunities."[33] As of December 31, 2012, InterDigital claimed to have over 19,000 patents and patent applications related to wireless communications.[34] InterDigital further claimed that some of its patents were "essential to cellular and other wireless standards, including the 2G, 3G, 4G and the IEEE 802 suite of standards."[35] In addition to Samsung and Apple, InterDigital appears to have license agreements with companies such as u-blox AG,[36] Cinterion Wireless Modules GmbH,[37] Sierra Wireless,[38] Acer, Pantech, Wistron,[39] BlackBerry, Quanta Computers, and Sony, each covering 2G, 3G, and 4G wireless technologies.[40] It likely has license agreements with other companies as well.

Using comparable licenses to calculate the appropriate royalty rate in patent infringement litigation is not a novelty. In the United States, the first and second Georgia-Pacific factors specify that "[t]he royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty," and "[t]he rates paid by the licensee for the use of other patents comparable to the patent in suit" are relevant to a reasonable royalty calculation,[41]

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[30] InterDigital 2012 10-K, pp. 15, 21, and 22.

[31] InterDitigal Form 8-K, September 07, 2007, "Item 8.01. Other Events," *available at* http://ir.interdigital.com/secfiling.cfm?filingID=1157523-07-9039&CIK=1405495.

[32] InterDitigal Form 8-K, September 07, 2007, "InterDigital Updates Financial Guidance for Third Quarter 2007," *available at* http://ir.interdigital.com/secfiling.cfm?filingID=1157523-07-9044&CIK=1405495.

[33] InterDigital 2012 10-K, p. 3.

[34] *Id.*

[35] *Id.*

[36] U-box AG is a fabless semiconductor provider of embedded position and wireless communications solutions for the consumer, industrial, and automotive markets, headquartered in Switzerland.

[37] Cinterion is a supplier of cellular M2M communication modules headquartered in Munich, Germany.

[38] Sierra Wireless is a supplier of hardware, software, and connected services for mobile lifestyles and M2M communications based in Richmond, Canada.

[39] Wistron is an original design manufacturer in the laptop market based in Taiwan.

[40] InterDigital 2012 10-K, pp. 9-10.

[41] *Georgia-Pacific Corp.* v. *US. Plywood Corp.*, 318 F. Supp. 1116 (S.D.N.Y. 1970).

and these factors have been widely used by the U.S. courts in determining reasonable royalty rates in patent infringement cases.

For the calculation of a FRAND royalty rate in an SEP setting, these two factors would still apply, potentially with slight modifications. In *Microsoft v. Motorola*, Judge Robart proposed that the first factor should be modified in a FRAND setting to limit the consideration of royalties received by the patentee for the licensing of the patent in suit to royalties negotiated in situations comparable to a FRAND licensing negotiation.[42] In *In re Innovatio*, Judge Holderman referenced Judge Robart's modified factors when evaluating the licenses that the parties proposed as comparable licenses.[43]

Determining which licenses, if any, are appropriate comparables, and calculating the FRAND royalty rate using those comparable licenses are not easy exercises, however, as demonstrated by the courts' analyses of the proposed comparable licenses in *Microsoft v. Motorola* and *In re Innovatio*.

First, one has to evaluate the economic circumstances under which the proposed comparable licenses were negotiated, and whether those circumstances are sufficiently comparable to the economic circumstances in a RAND licensing negotiation. For example, in both *Microsoft v. Motorola* and *In re Innovatio*, a 2011 license agreement between Motorola and VTech Holding Ltd. ("VTech") was proposed by one of the parties as a potential comparable license, but was rejected by the judges in both cases.[44] The judges were concerned that Motorola and VTech entered into the license to settle litigation, and thus that the royalty rate was influenced by the desire to avoid litigation risk and expenses rather than reflecting an accurate market-determined rate for Motorola's patents. Moreover, the judges were also concerned that there was some possibility that the Motorola-VTech rate was engineered by Motorola to justify its position in the *Microsoft v. Motorola* litigation, and did not actually reflect a significant exchange of value between the parties.

Another set of licenses proposed in both *Microsoft v. Motorola* and *Innovatio* as potential comparables were two licenses entered into by Symbol Technologies, Inc. ("Symbol"), which was later acquired by Motorola. In one license agreement, the licensee was Proxim, Inc. ("Proxim") and in the other license the licensee was Terabeam, Inc. ("Terabeam").[45] In both cases, the two Symbol licenses were rejected as comparable licenses to the patents-in-suit because they may have reflected hold-up value. Both licenses were negotiated when the licensees were under the duress of litigation. In particular, prior to both license negotiations, Symbol had won a jury verdict of $22.9 million against Proxim.[46] There is no evidence that the jury took into account Symbol's RAND obligation when determining the damage award.[47]

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[42] *Microsoft* v. *Motorola,* pp. 35-36.

[43] *In re Innovatio,* p. 9.

[44] *Microsoft v. Motorola, pp. 132-135; In re Innovatio, pp. 59-62.*

[45] Terabeam acquired the assets of the Proxim, but did not assume the cross-license agreement between Proxim and Symbol.

[46] *Microsoft v. Motorola, p. 142; In re Innovatio p. 64.*

[47] *Microsoft v. Motorola, p. 142; In re Innovatio p. 65.*

The InterDigital-Samsung license, which the Shenzhen Intermediate People's Court might have used as a comparable license, "ended all litigation and arbitration proceedings then ongoing between the parties," indicating that it was reached as a result of litigation settlement.[48] The other potential comparable license mentioned, the InterDigital-Apple license, does not appear to be an explicit settlement of litigation. However, it might not have been entered based on RAND considerations, considering that it was signed in 2007, two years before InterDigital joined ETSI. Thus, the InterDigital-Samsung and InterDigital-Apple licenses may not be suitable comparables for evaluating a FRAND rate for InterDigital's SEPs.

Second, one has to consider whether there are other patents in addition to the patents-in-suit covered by the license and, if there are, apportion the royalty rate between the patents-in-suit and the other patents. Many license agreements cover a large portfolio of patents of which the patents-in-suit are only a small subset. For example, two other Symbol licenses, both with LXE, Inc. ("LXE"), were also proposed as comparable licenses by the plaintiff in *In re Innovatio*. However, the judge rejected these two licenses as comparable because the plaintiff failed to determine the portion of the royalties in these agreements that were attributable to the 802.11 patents as opposed to other patents.[49]

The InterDigital-Samsung license covers the 2G and 3G patented technologies for a limited time frame, but not 4G. As for the InterDigital-Apple license, it is not clear from publicly available information what specific patents the license covers. From publicly available information regarding the China part of the *Huawei v. InterDigital* litigation, it appears that the court's ruling on the 0.019 percent FRAND rate ceiling covers all of InterDigital's 2G, 3G, and 4G essential Chinese patents that any Huawei product may have used and would be using. Thus, it appears that the patents covered by InterDigital's licenses with Apple and Samsung may not be totally identical to what would be included in the license with Huawei.

Third, one also has to consider whether there are other terms covered by the proposed comparable license, such as grant-backs, cross-licenses, and patent transfers. These terms would not be present in the FRAND license, and thus an otherwise comparable license with such terms may not provide a reliable benchmark for the FRAND rate. For example, in *Microsoft v. Motorola*, one of the reasons that the judge rejected the Motorola-RIM license as a comparable license was that it was a "fairly broad cross-license," making it difficult to apportion the value of the patents-in-suit from the other licensed properties.[50]

In *Huawei v. InterDigital*, it is unclear whether the InterDigital-Samsung license and InterDigital-Apple license have such terms. According to the judges' article, InterDigital asked for a license-back of Huawei's entire patent portfolio.[51] The judges determined that the fact that InterDigital did not make products, yet asked for such a license-back, exacerbated InterDigital's FRAND violation. However, cross-licensing by itself is common in bilateral licensing

[48] InterDigital 2012 10-K, p. 17.

[49] *In re Innovatio p. 66.*

[50] *Microsoft v. Motorola, p. 137.*

[51] Ye 2013 *supra* note 15 at 47.

negotiations. According to a 2011 interview of Huawei's general counsel, cross-licensing is an important part of Huawei's licensing agreements.[52]

Fourth, one needs to compare whether the proposed comparable license includes the same patented technology, and whether the technology is of similar significance to the licensee. For example, in *In re Innovatio*, one of the reasons that the Qualcomm-Netgear license was rejected by the court as a comparable license was that this license involved the 802.16 and 802.20 standards, rather than the 802.11 standard, which was the standard for which the patents-in-suit were allegedly essential. Although the 802.16 and 802.20 standards are part of the "4G standards" for cellular connections, and they, like 802.11, are "wireless air interface standards," no evidence was presented regarding the economic comparability of 802.11 networks and 802.16/20 networks, and thus the court determined that "in the hypothetical RAND negotiation, the parties would not rely on the Qualcomm-Netgear license agreement to assist in ascertaining an appropriate RAND royalty rate for the patents-in-suit."[53]

In *Huawei v. InterDigital*, as noted above, both the InterDigital-Samsung license and the InterDigital-Apple license may be different from the license InterDigital proposed to Huawei in terms of their coverage of the 2G, 3G, and 4G standards. Even within a given generation of cellular standards, there are different specific standards. For example, 2G standards include GSM and CDMA, and 3G standards include WCDMA, CDMA2000, and TD-SCDMA.[54] These specific standards have been adopted in different countries. Depending on where the end products are made for and shipped to, different specific standards may be relevant. Depending on the specific SEPs and their importance in the relevant specific standards, InterDigital's licenses with Samsung and Apple may or may not be comparable to the license proposed to Huawei, and the FRAND rates may be different across these different licenses. In cases where a license does not align exactly, it is necessary, if possible, to make the economically appropriate adjustments to derive a comparable rate.

Fifth, for a license to be a valid comparable, the licensee should be comparable to the company seeking the FRAND license in terms of the products it sells and its use of the patented technology. For example, if the InterDigital-Samsung license and InterDigital-Apple license were to be used as comparables, Samsung's and Apple's relevant products and how these products benefit from InterDigital's patent portfolio would have to be shown to be sufficiently similar to Huawei's relevant products and its use of InterDigital patents under the proposed license. If they were not sufficiently similar, appropriate adjustments would need to be made in order to utilize these licenses as comparables.

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[52] *See* http://it.sohu.com/20110409/n280195071.shtml. According to this interview report, Huawei's general counsel also indicated that Huawei paid $220 million licensing fee in 2010 (besides cross-licensing offers) to achieve $28 billion sales. The implied average royalty rate based on Huawei's end product sales was close to 0.8 percent (not taking into account of the monetary value of the cross-licensing terms). However, such an average rate would presumably include licensing rates not under FRAND obligations, and would presumably not have included any royalty payment that InterDigital demanded.

[53] *In re Innovatio p. 68.*

[54] Ye 2013, *supra* note 15.

Sixth, if the comparable license includes a lump-sum payment, when turning it into a per unit royalty rate one should use the projected sales units at the time of license negotiation as the denominator, instead of the actual sales units. This is because one should recreate the negotiation as it happened, including the information known at that time. The lump sum payments specified in the InterDigital-Apple license, which was signed in 2007, would have been based on the parties' projections of Apple's iPhone sales as of 2007. It is quite likely that projections made at that time failed to anticipate the level of success that the iPhone actually achieved in later years.

C. Other Methods of Determining FRAND Royalty Rates

There are other methods for determining FRAND royalty rates than using comparable licenses. These methods can sometimes provide a better estimate of the appropriate FRAND royalty rate, especially in situations where existing licenses have important areas of incomparability.

One method is called the "top-down" approach, as proposed by the defendant's expert and adopted by the court in *In re Innovatio*.[55] This has three steps. First, the defendant's expert proposed that the court should start with the smallest salable unit that incorporates the patents-in-suit, which in *In re Innovatio* was found to be the Wi-Fi chip. Second, the maximum royalty burden for the entire set of SEPs, expressed as a percentage of the selling price of the smallest salable unit, should be determined. Finally, this total royalty burden should be apportioned between the patents-in-suit and all of the other SEPs.

The court agreed with this proposal and considered this approach of having several advantages, such as being consistent with the non-discriminatory principle of FRAND and avoiding the royalty stacking problem. In performing the "top-down" method, the court first determined the average selling price of a Wi-Fi chip over time, and then determined the percentage of that price that corresponded to the average operating profit of a chip maker, which is an upper bound for the maximum royalty burden. Next, the court determined the portion of the maximum royalty burden for all of 802.11 SEPs that should be attributed to the patents-in-suit. In *Huawei v. InterDigital*, it could have been possible to collect relevant data points, such as the number of 2G, 3G, and 4G standard-essential patents, to conduct a calculation using a similar "top-down" approach.

Another method for determining a FRAND royalty is called the "bottom-up" approach, which was also proposed by the defendant's expert in In *re Innovatio*. Such an approach attempts to uncover the true value of the patented technology by directly examining the technology at issue. In a hypothetical negotiation, a licensee would not pay more for the patents-in-suit than the incremental costs that would have resulted from using the next best alternative (where the incremental costs may include lost benefits if the alternative performs less well).

In practice, the "bottom-up" approach requires one to first determine the extra cost of implementing the next best alternative to the patents-in-suit that could have been adopted into the standard, and then divide that cost by the projected total number of infringing units. This value places an upper-bound amount on royalties for the patents-in-suit. Potential alternatives to

[55] *In re Innovatio pp. 22-23.*

the patents-in-suit would include, for example, alternative proposals that were actually presented by standard-setting organization members during the standard-setting process.

In *Innovatio*, the court found that there were no alternatives to the Innovatio patents that would provide all of their functionality with respect to the 802.11 standard. The court was also concerned that a "bottom-up" analysis was too complicated for courts to perform.[56] However, determining royalty rates based on an analysis of next best alternatives is commonly done in patent litigation outside of the FRAND context. In *Huawei v. InterDigital*, it might have been possible to find reasonable alternatives to the InterDigital patents-in-suit that could have been adopted into the standard, determine both the cost of implementing those alternatives and the total number of infringing units, and then calculating the FRAND royalty using the "bottom-up" approach.

V. CONCLUSION

In this article, we attempt to provide some U.S. perspectives to *Huawei v. InterDigital* based on the latest developments in FRAND rate determination for SEPs. Applying the methods discussed in this article typically requires the involvement of economic experts. In both *Microsoft v. Motorola* and *In re Innovatio*, testimonies provided by economics experts on both sides were carefully reviewed and evaluated by the judges, and played an important role in the final judgment.

In China, although economic experts have started to play a role in antitrust cases, they are still largely absent in intellectual property litigation. In order for the judges to implement a more rigorous and scientific calculation of royalty rates in FRAND settings and in other complex intellectual property infringement cases, the parties need to tender sufficient evidence and in-depth economic analyses. Given the globalization of intellectual property litigation and the importance of China in business activities and strategies, such a trend can be expected in the near future.

[56] *In re Innovatio p. 72.*

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Towards a Simplified Review Procedure for Mergers in China

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Towards a Simplified Review Procedure for Mergers in China

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I. INTRODUCTION

In 2013, the Ministry of Commerce ("MOFCOM") published the much-awaited *Interim Regulations on Standards Applicable to Simple Cases of Concentrations between Business Operators* ("Draft Regulations") for public comment.[2] MOFCOM clearance has often trailed clearance in other major jurisdictions, including for cases that raise no significant competition concerns, or with little or no nexus, with China. The Draft Regulations are a welcome development, and are indicative of MOFCOM's efforts to respond to criticism from the business community and observers about the length of its merger reviews. Some officials estimate that around 50 percent of notified transactions could be processed under the proposed procedure.[3]

In terms of policy design, MOFCOM has opted for a set of rules that define *ex ante* categories of transactions (or *simple cases*) that ordinarily do not give rise to competition concerns and whose review will presumably be completed on an expedited basis. However, there are exceptions and the Draft Regulations identify cases where the simple case designation—and thus the benefit of a fast track procedure—would not apply or could be withdrawn. These exceptions raise questions around the predictability and certainty of the simple case procedure. The Draft Regulations also stop short of a commitment by MOFCOM to review simple cases on a timely basis and within Phase I, and offer no guidance on the procedures that MOFCOM will adopt in such cases. That said, the introduction of this procedure is welcome.

In this article, we consider certain aspects of China's merger review process that underscore the need for a simplified procedure for non-problematic deals (Section II), the *ex ante* criteria adopted by MOFCOM to identify simple cases and the circumstances in which the simple case designation would not apply or could be withdrawn (Section III), and some of the

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[2] MOFCOM circulated an earlier iteration of the Draft Regulations for restricted comment as part of an initial consultation process.

[3] *See China's MOFCOM approves simple-case notification threshold, official says*, PaRR (December 2013). The 50 percent rate is comparable to the share of transactions reviewed by the European Commission under the simplified procedure before the recent amendments to the procedure to extend the scope of transactions covered were adopted. The European Commission's indicative roadmap of the planned "merger simplification project", published in January 2013, outlines the objective for extending the scope of the simplified procedure under the European Union Merger Regulation. It notes that, during the period 2008-2010, simplified cases represented about 56 percent of the European Commission's merger cases—increasing to slightly more than 60 percent in 2011 and 2012. The European Commission expects the extension of the coverage of the simplified procedure to increase the number of simplified cases by an additional 10 percent.

procedures that may need to be introduced in order to maximize the benefits of the proposed simple case procedure (Section IV).

II. TOWARDS CHANGE

China's Anti-Monopoly Law ("AML") requires merging parties to notify transactions to MOFCOM if certain turnover thresholds are met,[4] and not to complete the notified transaction until receipt of MOFCOM approval. It is common for MOFCOM's clearance to lag behind approvals in other jurisdictions, and this has had a consequential impact on deal timetables and transaction costs for merging parties. The reasons for the often-longer review period in China are varied. The main drivers lie in the nature and design of the merger control process.

First, the statutory review period does not commence until MOFCOM has declared the notification complete. There are no statutory deadlines for this pre-acceptance phase.[5] In practice, this period can take up to eight weeks or longer depending on: deal complexity; the nature of the products, services, or sectors involved; questions around market definition; internal priorities; resources; etc. MOFCOM has made noticeable efforts in recent months to shorten this period in some cases by, for example, setting deadlines for merging parties to respond to information requests, scoping and reducing the number of rounds of information requests during this period, and leaving thorny questions (e.g. around market definition) to be settled following case acceptance and the start of the statutory review period.

Second, compared with other major merger control regimes, MOFCOM tends to consult an inordinate number of stakeholders, including other government agencies and departments with industrial policy and/or relevant sector oversight and trade associations—as well as competitors, customers, and suppliers. The consultation process can be long and the speed with which stakeholders revert with comments is typically not within MOFCOM's control.

MOFCOM will typically delay its final decision until it has completed consulting relevant stakeholders. Phase II investigations are thus commonplace, as MOFCOM is often unable to complete its review within the initial Phase I review period.[6] Indeed, the AML does not require MOFCOM to establish serious competition concerns to trigger an in-depth or Phase II inquiry. That said, transactions that do not raise substantive competition concerns, but end up in Phase II, are often cleared within a few weeks of Phase II—generally within one to one-and-a-half months of the start of Phase II review.

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[4] A transaction requires notification to MOFCOM if either of the following thresholds are met: (i) the combined worldwide turnover of the parties to the transaction exceeds RMB 10 billion, and each of at least two of them generates turnover in China of RMB 400 million or more; or (ii) the combined China turnover of the parties to the transaction exceeds RMB 2 billion, and each of at least two of them generates turnover in China of RMB 400 million or more.

[5] MOFCOM has a total statutory review period of 180 days: 30 days for Phase I, 90 days for Phase II review, and 60 days for an Extended Phase II review.

[6] According to an annual review for 2013 published on MOFCOM's website on December 4, 2013, during the period January 1 to October 31, 2013, MOFCOM received 185 merger filings, and it accepted 175 and closed 161 of them. The annual review also indicates that of the 161 closed cases, MOFCOM closed 21 (or 13 percent) in Phase I, 130 (or 80.7 percent) in Phase II, and 10 (or 6.3 percent) in the Extended Phase II period, respectively.

Third, unlike other major jurisdictions, the AML instructs MOFCOM to take non-competition issues into account during its merger review. The AML requires assessment of a transaction's impact on national economic development. The notion of national economic development is not defined under the AML or its implementing regulations, and it appears to encapsulate a broad spectrum of factors. It is not unusual for considerations related to industrial policy, foreign investment, national security, or security of supply and sourcing of products or services key to China's development to prolong MOFCOM's review, as it consults with and coordinates comments from relevant stakeholders on a notified transaction.

Last, there are significant constraints on MOFCOM's resources. The Anti-Monopoly Bureau within MOFCOM, which is responsible for processing notifications, reportedly has a small pool of 30-40 officials. Since the entry into force of the AML, the number of transactions notified to MOFCOM has steadily increased. In the past year, MOFCOM cleared 215 transactions.[7]

The review process in China is thus often protracted and fraught with unpredictable clearance timetables compared with other jurisdictions—often spanning four to five months from notification to clearance in the simplest of cases. The Draft Regulations signal MOFCOM's efforts to streamline merger review for transactions that pose little or no threats to competition in China and reduce the time it takes to review such transactions.

III. TOWARDS SIMPLICATION: QUALIFYING VS. EXCLUDED TRANSACTIONS

The Draft Regulations seek to establish criteria for distinguishing between simple cases and normal cases, namely transactions that meet the Chinese filing thresholds but present no significant competition concerns in China. The Comments to the International Competition Network Recommended Practices For Merger Analysis advise that "merger review laws and policies should provide competition agencies with the ability to differentiate mergers that are unlikely to have significant anticompetitive effects from those that require analysis."[8] This differentiation should allow competition authorities to focus available resources on transactions that require more detailed analysis and threaten to harm competition.[9] These recommended practices are non-binding and it is for each competition authority to design its own procedures for identifying non-problematic transactions and processing them expeditiously.

For merging parties, a simplified procedure typically reduces the administrative burden involved in preparing a notification in terms of the time, effort, and resources needed to prepare and submit a complete notification. A simplified procedure also offers merging parties certainty

[7] This is based on statistics published on MOFCOM's website. Four of the 215 approved transactions were cleared subject to conditions. The conditional clearances concerned, respectively, Glencore's acquisition of Xstrata, Marubeni's acquisition of Gavilon, Baxter's acquisition of Gambro, and MediaTek's acquisition of MStar. A significant proportion of mergers continue to be approved in China without remedies.

[8] *See* Comments to ICN Recommended Practices for Merger Analysis, Article I.A. The recommended practices reflect best practices among member competition authorities. MOFCOM is currently not a member of the ICN.

[9] *See* Comments to ICN Recommended Practices for Merger Analysis: "the identification of those mergers that potentially threaten to harm competition and expeditious clearance of non-problematic mergers can lead to more efficient use of agency resources and more effective analysis of critical legal and economic issues."

that the notified transaction does not raise substantive competition concerns, and a degree of predictability as to the likely timing of the competition authority's merger review.

For example, in the European Union—the model that MOFCOM's proposed simplified procedure most closely mirrors—transactions notified under the simplified procedure require significantly less resources than in normal cases. Further, they are subject to more limited information requirements, and may be approved in Phase I following a lighter review, which does not involve extensive market inquiry. It is against this background that we consider the Draft Regulations.

A. Qualifying Transactions

Article 2 of the Draft Regulations identifies six categories of cases that MOFCOM considers are unlikely to have significant anticompetitive effects in China. A principal criterion is market share. Article 2 defines a transaction as "*simple*" based on the following market share tests: (i) in the case of a horizontal merger, if the merging parties have a combined market share of less than 15 percent in the relevant market; (ii) in the case of a vertical merger, if the parties' market share is less than 25 percent in the relevant product upstream or downstream market; and (iii) in cases where the merging parties are not in a vertical relationship, if the parties have a market share of less than 25 percent.

The focus on market share is unfortunate, as market share-based tests are inherently imprecise. Market shares can be difficult to determine as this depends on market definition and the availability of reliable data and information. The European Commission similarly uses market share-based tests, and has done so for over a decade. However, the challenge in the China setting is the lack of detailed guidance and precedents on market definition. There are few precedents for market definition in China. This is because MOFCOM is not required to publish merger decisions unless they issue a prohibition or conditional clearance decision.[10] In addition, the few decisions that are published often do not contain a detailed analysis of market definition.

Moreover, MOFCOM's current practice is to define the relevant market(s) affected by a transaction and not to leave this open even in non-problematic cases. It tends to both define markets narrowly and explore alternative market definitions. There is thus a risk that merging parties may be required to consider all plausible alternative market definitions to satisfy MOFCOM that the relevant market share test for simple status is met. This could prove time-consuming and protracted, leading at least some merging parties to simply choose to follow the normal case route to avoid possible delays.

The Draft Regulations usefully provide other scenarios for simple case status, which are not market share-based. First, transactions involving non-Chinese targets are simple if the acquired foreign target does not engage in economic activity in China. Second, the creation of a joint venture ("JV") will qualify as simple if the JV is established outside China and does not engage in economic activity inside China. However, in both cases, engaging in economic activity is not defined, and it is unclear whether *any* level of economic activity in China (e.g. nominal sales or assets, or even a sales rep office) would preclude simple status. If de minimis sales or presence is unlikely to impact the competitive process in China, but is still considered to be

[10] MOFCOM has published full decisions in 22 cases since the AML came into force.

economic activity inside China, there is a risk that some transactions with no significant anticompetitive effects may still be reviewed under the normal case process.

Last, if a parent of a jointly controlled JV acquires sole control over the JV then the transaction will qualify as simple unless the parent and JV are competitors in a relevant market (see further below). JVs account for nearly 35 percent of MOFCOM's current caseload. A relatively high proportion of notified JVs have no China nexus or concern the restructuring of an existing JV, and thus are unlikely to harm competition or consumers in China.[11]

B. Excluded Transactions

Article 3 of the Draft Regulations establishes six broad exceptions to simple case designation. These exclusions appear to be aimed at carving out a subset of cases where the simple case qualification would not apply even if the Article 2 tests were met.

First, a transaction between a parent and its JV in circumstances where a jointly controlling parent acquires sole control over the former JV, is not considered simple if the parent and JV are competitors in a relevant market. It is not clear why a merger between a parent and its JV that results in a low post-merger combined share (or below the 15 percent market share test for *simple* horizontal mergers) should raise greater competition concerns than a horizontal merger between previously independent competitors that leads to an equally low post-merger combined share. The European Commission establishes a similar exception but, as it explains in its Notice on simplified procedure, such cases are exceptional and assume that the merged entity will have a significant market position.[12] The extent to which the parties actually competed pre-merger also plays an important role.

Second, a case is not simple if the relevant market is difficult to define. Other competition authorities with a simplified procedure for non-problematic transactions similarly exclude the benefit of the lighter procedure where market definition is difficult. However, such situations are exceptional and are often confined to special cases (e.g. where market definition raises novel legal issues). With the limited number of Chinese precedents and MOFCOM's tendency to drill down market definition, this exception could mean that a number of transactions with no significant competition concerns will remain subject to the normal merger procedure. The question of market definition should, of course, not be relevant to the non-market share based simple status

[11] As of December 31, 2013, MOFCOM had reviewed nearly 750 transactions since the entry into force of the AML. Based on statistics published by MOFCOM, approximately 33 percent of the cleared transactions involved joint ventures.

[12] Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004, ¶16:

> [a] particular competition concern could arise in circumstances where a former joint venture is integrated into the group or network of its remaining single controlling shareholder, whereby the disciplining constraints exercised by the potentially diverging incentives of the different controlling shareholders are removed and its strategic market position could be strengthened. For example, in a scenario in which undertaking A and undertaking B jointly control a joint venture C, a concentration [where] A acquires sole control of C may give rise to competition concerns [if] C is a direct competitor of A and where C and A will hold a substantial combined market position and where this removes a degree of independence previously held by C.

See also Cases IV/M.1328, *KLM/Martinair*, Twenty-Ninth Report on Competition Policy 1999 ¶¶165-166, and COMP/M.5141 *KLM/Martinair*, 17.12.2008 ¶¶14-22.

tests under Article 2. But, where market definition is a key element in the assessment, it will be important to limit the circumstances in which MOFCOM officials may rely on the exception to deny simple status.

Third, transactions are not simple if they are likely to have a detrimental impact on market access, technological progress, consumers or other third parties, national economic development, or competition. This is consistent with the criteria that the AML requires MOFCOM to consider when conducting merger reviews. However, Article 3 does not explain the particular circumstances in which a simple case (which otherwise satisfies the simple status test) may have such an impact. Nor do the AML or MOFCOM's guidelines on the assessment of competition effects shed any further light.[13] This leaves considerable discretion to MOFCOM. In particular, national economic development enables an array of non-competition considerations–often driven by other government agencies or departments with industrial policy or sector responsibility–to be taken into account. In the absence of guidance, it will be difficult to predict with certainty whether MOFCOM could decide that a transaction may have a detrimental effect on China's economic development.

Last, under Article 4 of the Draft Regulations, MOFCOM may withdraw the simple case qualification if: (i) a notifying party provides incomplete, false, or misleading information;[14] (ii) a third party complains that the notified transaction has or may have the effect of restricting or eliminating competition; or (iii) there are material changes to the notified transaction or to market conditions.

Article 4 does not set any time limits for MOFCOM to withdraw the simple qualification. Equally, third parties are not subject to any deadlines within which to challenge a transaction. The broad scope of Article 4 suggests that MOFCOM may return to the normal merger procedure at any time during the 180-day statutory review period, and that it may re-evaluate a transaction it has already approved at the request of a third party or based on changed market conditions.

IV. TOWARDS AN EFFECTIVE SIMPLIFIED REVIEW PROCEDURE

The simple case criteria proposed in the Draft Regulations are an initial step in the establishment of comprehensive set of regulations for implementing the envisaged simplified review procedure. The effectiveness of the Draft Regulations in shortening merger review periods for transactions which raise no significant competition concerns in China risks being undermined without complementary procedural regulations, which clarify the implications of simple status. It thus remains to be seen how effective the envisaged simplified review procedure will be.

MOFCOM is currently considering a complementary set of regulations that will explain how the simplified review procedure will be implemented. To maximize the anticipated benefits of simple case qualification, it will be important to implement procedures that, inter alia, offer

[13] *See* Article 27 of the AML and Provisional Regulation on the Assessment of the Impact on Competition of Concentrations between Business Operators, [2011] MOFCOM Order No. 55, Aug. 29, 2011.

[14] The prospect of sanctions if incomplete, false, or misleading information is provided should limit the circumstances in which this scenario could arise.

predictability as to the merger review timetable, certainty that a transaction does not raise substantive competition concerns, and lessen the administrative burden on merging parties when preparing notifications under the simplified route. Below, we consider a few guiding principles.

In terms of the merger review timetable, a commitment to a complete review of a simple case within Phase I (i.e. within 30 days of case acceptance) will be important. The consultation process outlined above may need to be adapted and streamlined to facilitate completion of MOFCOM's review within Phase I. It will also be useful to set time limits for making a simple status request and its determination, and for withdrawing simple status, especially if driven by a third party.

Given the current design of the merger review process, the determination of whether a transaction merits simple status should be settled ideally during the pre-acceptance phase. Merging parties may be required to indicate whether a transaction merits simple status, and to provide the necessary information to support such status during the pre-acceptance phase. This would enable MOFCOM, as it reviews the notification for completeness, to determine whether a transaction deserves simple status. Early determination of simple status will give merging parties the necessary comfort that their transaction does not raise significant competition concerns and that it will be reviewed on an expedited basis.

During the determination, it will be important to involve one or more members of the case team who will review the transaction after case acceptance. This will ensure that the determination is less likely to be subject to withdrawal, unless exceptional circumstances arise after case acceptance.[15] In addition, a third party that seeks to challenge a simple case designation should be required to substantiate its complaint.

With respect to information requirements, pre-consultation discussions with the Anti-Monopoly Bureau within MOFCOM may, of course, assist in scoping the information to be provided when filing a case under the simplified review procedure. Because such meetings are discretionary, merging parties and their advisers may need to decide in the first instance what information is not necessary for a simple case. A few sections of the current notification form already allow notifying parties to omit certain information. These sections may serve as a useful starting point for determining what information can be omitted in simple cases. It remains to be seen whether MOFCOM will adopt an alternative notification format for simple cases.[16]

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[15] If MOFCOM does not accept the merging parties' simple case designation, or decides to withdraw that designation, early notification will enable merging parties to submit additional information, if necessary, for an extended review.

[16] An ICN Notification & Procedures Subgroup paper notes:

> [t]he choice between a short and a long form offers an important mechanism for flexibility in transactions deemed to lack significant anti-competitive impact… Both forms typically ask for… information for administrative purposes, information about the parties to the filing, and a description of the transaction. Both forms also ask for some level of competitive analysis. The difference lies, for the most part, in the breadth of information required relating to competitive effects.

See Information Requirements for Merger Notification, presented at the 8th Annual Conference of the ICN in 2009, II.A.1 and 3. Flexibility can be assured whether a competition authority uses alternative notification forms or permits notifying parties to make a full or simplified notification using a single form (e.g. by permitting parties to omit specific sections of the notification form).

V. CONCLUSION

The Draft Regulations seek to identify categories of cases that are unlikely to have significant anticompetitive effects and can presumably be earmarked for expedited review. The envisaged simple case procedure will allow MOFCOM to focus on transactions that require more detailed analysis. For merging parties, simple status should facilitate the planning of deal timetables and completion on a timely basis.

The Draft Regulations are a significant and positive development in the evolution of MOFCOM's merger control process. The identification of specific categories of cases that may benefit from expedited review is welcome. However, the broad exceptions to the simple case designation, and the scenarios in which simple status can be withdrawn, risk undermining the effectiveness of the proposed simplified procedure.

MOFCOM is expected to introduce a further set of regulations on how the simplified review procedure will be implemented. It is hoped that these regulations will outline how simple status will be determined and when such a determination will be made. Further, it is hoped that the practical implications for treating a case as simple—in particular, the timing of the merger review and the information that merging parties need to provide—will be further detailed.

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Consideration of Economic Evidence by Chinese Courts in Antitrust Litigation

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Fang QI, Marshall YAN, & Yan LUO[1]

I. INTRODUCTION

The Anti-Monopoly Law ("AML") provides civil remedies to plaintiffs who have suffered damages "caused" by defendants' monopolistic conduct.[2] To grant remedies in an AML case, Chinese courts demand evidence showing that the defendant has engaged in monopolistic conduct, and that the "anti-monopoly injury" to the plaintiff is "causally linked" to the defendant's monopolistic conduct.[3] As the determination of these issues is based on antitrust economics, economic evidence plays a fundamental role in AML litigation.

This article examines the approaches that Chinese courts have taken to evaluate economic evidence in AML cases by examining the courts' rulings in two recent AML cases: *Rainbow v. Johnson & Johnson* ("*Johnson & Johnson*") and *Qihoo v. Tencent*. Although the approaches are likely to continue evolving as the Supreme People's Court has yet to issue any official guidelines for evaluating economic evidence, and lower courts in different provinces are still developing their approaches, a thorough analysis of the courts' approaches in the two cases can shed some lights on what parties will likely encounter in AML litigation.

The rest of the article is organized as follows. Part II discusses the general role of economic evidence as laid out in the AML. Part III discusses how the courts have considered economic evidence in connection with the determination of "relevant market" and "market position." Part IV focuses on the *Johnson & Johnson* court's analysis of competitive effects of resale price maintenance ("RPM"). Part V discusses how the courts have evaluated the relationship between the plaintiff's injury and the defendant's wrongdoing in order to determine whether the plaintiff is a proper party to bring an AML action and how to grant AML damages. Part VI concludes.

II. ROLE OF ECONOMIC EVIDENCE IN AML LITIGATION

The AML implies that economic evidence should play a prominent role in AML litigation for three reasons:

First, the AML proscribes many types of monopolistic conduct, such as anticompetitive agreements reached between competitors or upstream/ downstream business operators, various types of abuse of market dominance, and concentrations of business operators which have the

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[1] Fang QI (Fangda Partners), Marshall YAN (Cornerstone Research) and Yan LUO (Covington & Burling). The views expressed in this paper do not reflect those of the authors' institutions, and should not be attributed to any of the authors' clients.

[2] Anti-Monopoly Law of the People's Republic of China, [2008] Presidential Order No. 68, Aug. 30, 2007, Chapter VII.

[3] AML, Art. 50.

effect of eliminating or restricting competition.[4] In defining these types of monopolistic conduct, the AML purposefully used economically contextual terms, such as "monopoly," "abuse," "dominant market position," and "effect of eliminating or restricting competition."[5] The use of these terms, which have their deep roots in modern antitrust economics, shows that the legislative intent is to require the courts and enforcement agencies to conduct economic analysis in AML cases and base their decisions on sound economic evidence.

Second, the structure of the AML leaves room for a "rule of reason" style analysis: Article 15 allows certain pro-competitive agreements, though deemed "monopoly agreements," to be exempt from the application of Articles 13 and 14;[6] Article 17 provides a "justifiable causes" safe harbor for "abuses," similar to the functioning of Article 15 for agreements;[7] and Article 28 requires the enforcement agency to balance the pro-competitive effect with the anticompetitive effect of a concentration.[8] This statutory language compels a two-dimensional approach in AML cases: while the court or agency must first identify "monopolistic conduct," it should also examine whether the pro-competitive effect of the monopolistic conduct outweighs its anticompetitive effect. The determination of both monopolistic conduct and competitive effects has to be based on sound economic analysis, and only economic evidence can support the courts' finding one way or the other.

Third, the AML requires that, after identifying monopolistic conduct whose anticompetitive effect outweighs its pro-competitive effect, the courts must also examine whether the plaintiff's damages were "causally linked" to the defendant's monopolistic conduct.[9] This causation requirement includes both "but-for" cause and "proximate cause." The plaintiff must show that he/she would have not suffered the harm-at-issue "but for" the defendant's violations. To satisfy the "proximate cause" requirement, the plaintiff must be a "foreseeable" victim who suffered a harm that flows from the anticompetitive aspect of the defendant's violation.[10] Without accurate and reliable economic evidence, the judges cannot validate or refute contradictory claims made by parties regarding causation and damages, even if "monopolistic conduct" has been identified.

Given that the economically contextual terms and the "rule of reason" analysis are embedded in the AML, judges in AML litigation have to carefully consider economic evidence generated by parties with opposite interests.

III. CONSIDERATION OF ECONOMIC EVIDENCE RELATED TO RELEVANT MARKET

To determine liability under the AML, the courts need to assess whether the challenged conduct amounts to monopolistic conduct. Among the three types of monopolistic conduct

[4] AML, Art. 3.

[5] *Id.*

[6] AML, Art. 15.

[7] AML, Art. 17.

[8] AML, Art. 28.

[9] AML, Art. 50.

[10] *See e.g.*, Shanghai High People's Court, *Bangrui Yonghe Technology Trading Co., Ltd. v. Johnson & Johnson (Shanghai) Medical Equipment Co., Ltd. and Johnson & Johnson Medical(China) Ltd.*, August 1, 2013, [2012] Hu Gao Min San (Zhi) Zhong Zi No. 6, pp. 37-38.

enumerated in Article 3 of the AML, the second one—"[a]buse of dominant market position by business operators"—has been most frequently adjudicated in the courts so far.

Abuse of market dominance requires the courts to resolve three issues: (1) the delineation of the relevant market,[11] (2) the determination of defendant's market share and dominant position in the relevant market,[12] and (3) the defendant's abuse of its dominant market position.[13] This section summarizes the types of evidence considered by the courts in resolving the first two issues, while the third issue is discussed in the next section.

A. The Delineation of the Relevant Market

Article 12 of the AML provides that, "[f]or the purposes of this law, a relevant market is the product scope and the geographical scope where business operators compete against each other for a specific product or service [] within a certain period of time."

In economics, "relevant market" is the smallest product market for which the elasticity of demand and the elasticity of supply are sufficiently low that a firm with 100 percent of that market could profitably reduce output and increase price substantially above the competitive level.[14] This definition suggests the application of a demand—and supply—substitutability analysis in delineating a relevant market. It is also consistent with the principle of the Small but Significant and Non-transitory Increase in Price ("SSNIP") test, which inquires whether a small but significant and non-transitory increase in price would allow a hypothetical monopolist to profitably raise prices.[15] Both the demand—and supply—substitutability analysis and the SSNIP test have been conducted by the Chinese courts in delineating the relevant market in AML cases.

1. Substitutability analysis in the *Johnson & Johnson* case

The Shanghai High People's Court in *Johnson & Johnson* defined the relevant market of "sutures for medical use" by analyzing the demand-side and supply-side substitutability and considering whether the market can be further segmented.[16] In addition, the *Johnson & Johnson* court stated that a court is not obliged to conduct a SSNIP test in every AML case if the analysis of demand and supply substitutability is "sufficient" to dispose the delineation of the market.[17]

In *Johnson & Johnson*, plaintiff Rainbow Medical introduced evidence showing that the China Administration of Food and Drug ("CFDA") divided sutures into two sub-categories: non-absorbable sutures and absorbable sutures.[18] CFDA also explicitly states the permitted uses of different types/models of sutures in the "medical device certificates."[19] Based on this, Rainbow Medical argued that a narrower product market should be considered as different types/models

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[11] AML, Art. 12.

[12] AML, Arts. 18 and 19.

[13] AML, Art. 17.

[14] HERBERT HOVENKAMP, THE LAW OF COMPETITION AND ITS PRACTICE, 83 (1994).

[15] U.S. Department of Justice, Merger Guidelines § II n.6, *reprinted in* 4 TRADE REG. REP. (CCH) ¶ 13,102 (June 14, 1982); and Guidelines on the Definition of the Relevant Market, [2009], Anti-Monopoly Commission under the State Council, May 24, 2009.

[16] *Rainbow Medical v. Johnson & Johnson*, *supra* note 10, pp. 25-26.

[17] *Id.* at 26.

[18] *Id.* at 8.

[19] *Id.* at 8-9.

of sutures are not substitutable. In rebuttal, defendant Johnson & Johnson argued that the permitted uses of non-absorbable sutures overlap with these of absorbable sutures under CFDA's rules and these two types of sutures are substitutable.

Rainbow Medical's economic expert was of the view that sutures, by themselves, form a distinctive product market and that no SSNIP test needed to be performed.[20] The economic expert of Johnson & Johnson did not object to this definition, although he pointed out that analyses on supply and demand substitutability have to be considered before the court renders such a conclusion. On the same note, he suggested that the court conduct a SSNIP test.[21]

The court first held that evidence introduced by Rainbow Medical did not prove that the sutures market should be segmented and that non-absorbable and absorbable sutures would form different markets. Instead, as CFDA permits non-absorbable and absorbable sutures to be used interchangeably, in the court's view this showed that these products are in the same market.[22]

The court then considered the demand-side substitutability of sutures: Because there is no other device that can replace the role of sutures in a surgery, there is no substitute for sutures that can be put in the same product market. Similarly, on the supply side, the production of sutures requires specialized equipment and know-how. Manufacturers of other devices cannot directly switch manufacturing facilities for other products to those for sutures.[23]

On this note, the court concluded that it was not obliged by the Anti-Monopoly Commission's Guidelines on the Definition of the Relevant Market ("Guidelines") to conduct a SSNIP test. Instead, a relevant market could be defined by analyzing demand-side substitutability (considering factors such as physical characteristic, product usage, and price) and supply-side substitutability (if necessary). Only in exceptional circumstances, where the delineation of the market is blurred, does a SSNIP test need to be used to further analyze the market.[24]

2. Substitutability analysis and SSNIP test in the *Qihoo v. Tencent* case

In the *Qihoo v. Tencent* case, the Guangdong High People's Court conducted the most sophisticated analysis on the relevant markets among all AML judgments by Chinese courts to date. In addition to a comprehensive and complicated demand- and supply-substitutability analysis, the court conducted, for the first time, a SSNIP test to evaluate the proposed definition of product market.[25]

The court's analysis started with three types of "core" services that can form the narrowest product market, as agreed by both parties.[26] The plaintiff defined the relevant product market as instant messaging ("IM") software and services that allow multiple users to

[20] *Id.* at 14, ¶ 8.

[21] *Id.* at 16, ¶ 2.

[22] *Id.* at 25-26.

[23] *Id.* at 26.

[24] *Id.*

[25] *See* Guandong High People's Court, *Beijing Qihoo Technology Co. Ltd. v Tencent Technology (Shenzhen) Co. Ltd. and Shenzhen Tencent Calculation Systems Co. Ltd.*, March 20, 2013, [2011] Yue Gao Fa Min Chu Zi No. 2.

[26] *Id.* at 31 ¶ 2.

communicate in real time over the internet via text message, documents exchange, and voice and video calls. This market includes at least three types of "core" IM services: multifunctional IM services such as QQ or MSN, cross-platform IM services such as Fetion offered by China Mobile, and cross-network IM services such as Skype.

The court went on to consider whether four other groups of services were also within the same market as the IM services. The first group considered was voice and video call.[27] The court held that voice/video calls should be placed in the same relevant market with the "core" services, because a consumer can switch easily, immediately, and without cost between integrated IM services such as QQ and voice/video calls, and most providers offer the whole range of functionalities.

In its analysis, the court also made a reverse application of the SSNIP test. The court reasoned that, since consumers are price-sensitive when using IM services, a consumer will leave multi-functional services for single function services, if the former is not offered for free. Accordingly, a hypothetic monopolist of the multi-functional services market is unable to make a small, significant, and non-transitory increase of price while maintaining his market position. The court thus concluded that multi-functional services in themselves do not constitute a relevant market on their own.

The second group of services that the court considered was social networking and micro-blogging websites, which offer real-time communication services.[28] The court evaluated (i) the functionality of the services, (ii) the price sensitivity of consumers, and (iii) competition dynamics, and concluded that social networking websites are in the same market as IM. Similar to the court's analysis of the first group of services, the court also made a reverse application of the SSNIP test—inquiring whether a hypothetical monopolist would retain its market position had it made a SSNIP test. Since consumers would switch from one service to another if a monopolist IM service provider were to charge a price for its service, the two types of services should be placed in the same relevant market.

The third and fourth groups of services analyzed by the court were traditional telecom services (text messaging and phone) and emails.[29] The court's opinions were straightforward: these services do not have the same functionalities as IM services and are not substitutable. Also, customers have to pay to use telecom services, while IM services are offered for free.

After considering the above four factors, the court finally came to the conclusion that it must reject the plaintiff's market definition wherein IM services form a distinctive product market.

It is noteworthy that the court's analysis does not directly show how quantitative data were evaluated, and no independent market study was conducted to collect information from market participants. Instead, the court substantially relied on expert reports submitted by the parties for its analysis. Direct evidence, such as language in the prospectus issued by Tencent in the course of its initial public offering in Hong Kong, was mentioned, but the court considered

[27] *Id.* at 31 ¶ 3.
[28] *Id.* at 32 ¶ 4.
[29] *Id.* at 33 ¶¶ 5, 6.

that such statements had little bearing on the issue of market definition. Also, the court was very determined to find a concrete market definition, instead of engaging in an analysis of different scenarios for market definition.

B. The Determination of a Dominant Market Position

When presenting economic evidence to prove the defendant's dominant position in the relevant market, judges in both the *Johnson & Johnson* and the *Qihoo v. Tencent* cases held that a market share above 50 percent was not the sole determinant of market dominance.[30] Other factors that were considered by the courts included the ability to control price, quantity, or other terms of trade; the ability to raise barriers of entry; and the competitiveness of the relevant market.[31]

In *Johnson & Johnson*, the court analyzed the degree of competition in the relevant market and the defendant's abilities to control the market, such as its price-setting ability, brand name effect, and the ability to control the distributors downstream in the supply chain.[32] In *Qihoo v. Tencent*, the court inferred the defendant's market power from its capability to control the price and raise entry barriers, as well as the character of the relevant product and the degree of competition in the relevant market.[33]

1. Dominance inferred from the low level of competition in the *Johnson & Johnson* case

In assessing Johnson & Johnson's market position in the relevant market of medically usable sutures, the *Johnson & Johnson* court focused on Johnson & Johnson's leading position and various market-controlling powers in the not-so-competitive relevant market. The court did not accept Rainbow Medical's calculation of market shares, which was based on both a market study as well as Johnson & Johnson's statements on its website about its market share in the United States and worldwide. The court also rejected Johnson & Johnson's calculation that used the number of patients who had had surgeries in 2008 and the volume of sales of Johnson & Johnson's sutures to estimate the company's market share, and, instead, considered that the number (20.4 percent) underestimated the actual market share of Johnson & Johnson.[34]

The court instead focused on the fact that Johnson & Johnson is the leading supplier in the global suture market.[35] The court inferred that, since there is not sufficient competition in the medical suture market in China, Johnson & Johnson should also have a leading position in China. Johnson & Johnson failed to rebut the court's inference with evidence indicating the existence of any other competitor in the market that could possibly have a higher market share than Johnson & Johnson.

The court also inferred the high market share of Johnson & Johnson's products in Beijing's high-end hospitals based on Rainbow Medical's statement that, as a distributor, it had

[30] *See Johnson &Johnson,* at 28; *Qihoo v. Tencent*, at 35-37.
[31] *Id.*
[32] *Johnson & Johnson*, at 28-30.
[33] *Qihoo v. Tencent*, at 35-37.
[34] *Johnson & Johnson*, at 29.
[35] *Id.*

been authorized by Johnson & Johnson to supply ten high-end hospitals in Beijing.[36] Because each hospital can only choose a few brands of sutures, the court deducted that Johnson & Johnson's products must have a high market share in Beijing. The court also stated that Johnson & Johnson could leverage its influence in high-end hospitals to other hospitals.

In addition, as mentioned, the court strengthened its analysis with its assessments of Johnson & Johnson's various market-controlling powers, such as its price-setting ability, the brand name effect associated with J&J, and the capability to control downstream distributors.[37]

In particular, the court first noted that Johnson & Johnson's market position was reinforced by the company's ability to set prices, which it found to be demonstrated by the stable price over the past 15 years, and insufficient competition in the market.

Second, the court noted that Johnson & Johnson's brand name contributed to its market position. Being one of the leading healthcare providers in the global market, and one that had a great reputation in China, the court found Johnson & Johnson to have strong and well-established goodwill associated with the company brand name.

Third, the court concurred with Rainbow Medical that Johnson & Johnson had strong bargaining power over its distributors, thus conferring it a high degree of market power. For example, the court pointed out that Johnson & Johnson's distributors were required to sign exclusivity agreements and accept territorial restraints in terms of hospital costumers. Johnson & Johnson was also found to monitor the distributors' performance and renew their contracts every year.

The court concluded that these market-controlling powers, together with the relative low level of competition in the relevant market, suggested that Johnson & Johnson had a strong position in the market of sutures for medical use.

2. Dominance inferred from the market-controlling powers in the *Qihoo v. Tencent* case

Compared with the *Johnson & Johnson* court, the court in *Qihoo v. Tencent* conducted a more detailed and complex analysis of the defendant's market-controlling powers. The court explicitly noted that a market share above 50 percent—which, according to the AML, allows for a presumption of dominance—is not the sole determinant of dominance.[38] Other factors—including the ability to control price, quantity or other terms of trade, the ability to raise barriers of entry, and the degree of competition in the relevant market—need to be considered.

First, the court noted that the defendant had no ability to control price, quantity, or other terms of trade for three reasons.[39] As customers are unwilling to pay any fee for IM services, and all competing IM services were provided free of charge, the court held that the defendant did not have any price-setting ability that would prevail over its competitors. The court also found that

[36] *Id.*
[37] *Id.* at 29-30.
[38] *Qihoo v. Tencent*, at 35.
[39] *Id.* at 35-35.

customers could immediately switch to other IM services without a cost and that there was no demonstrable reliance on the defendant's services.

Second, the court considered that the defendant had no capability to raise barriers for new entrants.[40] In its view, the relevant market had low barriers to entry, because:

- there was no excessive capital or technical requirements to enter the market;
- past entrants came from different industries, such as telecom providers, social networking websites and gaming websites; and
- new entrants could quickly achieve shares in certain market segments because of their existing client base.

Also, the court considered that there were limited network effects in this market. Because each IM services user tends to communicate only with a limited number of "core" people in his/her network, the network effect would be significantly weakened. The defendant gave the example of MSN—before QQ entered into the market, MSN was the largest IM service provider in China. After only a quick period, QQ was able to take over a significant market share from MSN and became the largest IM service provider. The court accepted that this showed that network effects had little effect as an entry barrier.

Third, the court noted that IM services were part of a nascent and dynamic sector where new entrants and technologies can easily replace the existing players.[41] It found competitive constraints to come from traditional IM service providers, as well as new providers such as social media sites. As a result, the court thought it would be impossible for service providers to reduce the quality of the service by, for example, placing too much advertisement.

Finally, the court stated that there were potential entrants which had sufficient capital or technological capacity to enter the market and the defendant did not have the capacity to prevent those potential entrants from entering the market.[42] Companies such as China Mobile, China Telecom, China Unicom, Alibaba, and Baidu have all entered into this market and these are powerful competitors that have sufficient funding and technical capacity to compete.

In conclusion, the court stated, "due to special conditions of the Internet sector, market shares in particular cannot be deemed as a decisive factor in the determination of a dominant market position."

IV. CONSIDERATION OF ECONOMIC EVIDENCE RELATED TO ANTICOMPETITIVE EFFECTS

When analyzing whether the defendant had abused its market dominance, the *Johnson & Johnson* court conducted a "rule of reason" analysis—asking whether the pro-competitive effect of the concerned "abuse" outweighed its anticompetitive effect. The court stated that, because the challenged RPM contract could have both pro-competitive and anticompetitive effects, one

[40] *Id.* at 36.
[41] *Id.*
[42] *Id.*

needed to examine the actual effects of the contract in order to determine whether the contract was pro-competitive or anticompetitive in the real world.[43]

When assessing the actual effect of the defendant's RPM contract on competition, the *Johnson & Johnson* court considered evidence for both pro-competitive and anticompetitive effects. The court was of the view that some anticompetitive effects could be self-corrected by market forces or offset by pro-competitive effects, and that the RPM contract at issue should be deemed as a monopoly agreement only if it had actual anticompetitive effects that could not be self-corrected or offset.[44] Following this framework, the court found that there was strong evidence that the RPM contract at issue had actual anticompetitive effects that could not be corrected by the market. The court also determined that there was not enough evidence to substantiate the argument that the contract had pro-competitive effects.

When analyzing the contract's anticompetitive effects, the court first identified possible anticompetitive effects of RPM under economic theory, including reducing intra-brand price competition, limiting distributors' ability to freely set prices, increasing the likelihood of cartel behavior, and requiring excessive advertising and services. Without citing any evidence, the court determined that the possibility of excessive advertising and services could be self-corrected by the market. The court also found that there was no evidence showing the RPM contract at issue had any cartel-enhancing effect.[45]

Thus, the court chose to focus on the possible effects of the RPM contract on intra- and inter-brand price competition. By analyzing business and market evidence, the court determined that Johnson & Johnson's RPM conduct had reduced intra- and inter-brand price competition in the relevant market.

Regarding intra-brand price competition, Rainbow Medical introduced evidence showing that after it lowered its bids to supply Renmin Hospital, the price of the Johnson & Johnson product for this hospital stayed at the lowered level. The court interpreted this as evidence confirming that Rainbow Medical's pricing was not profit-losing and was the result of market forces. The court also agreed with Rainbow Medical's interpretation of the higher price of Johnson & Johnson's products, i.e. Johnson & Johnson's price was consistently higher than those of other brands (including other foreign brands) because its contract arrangements with its distributors enabled it to maintain prices above the competitive level.[46]

However, because RPM contracts are designed to limit intra-brand price competition while increasing non-price competition, the finding that the contract limited intra-brand price competition was not surprising and did not answer the question if the contract had reduced overall competition. It is interesting to note that the court used the comparison between Johnson & Johnson's price and the price of its competitors (including other foreign brands) as evidence to determine whether the defendant's price was above the competitive level. In doing so, the court

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[43] *Johnson & Johnson*, at 32.
[44] *Id.*
[45] *Id.*
[46] *Id.* at 32-33.

did not consider the possibility that Johnson & Johnson's price may have been higher because of factors such as better quality and services.

Regarding the effect on inter-brand competition, the court considered the following evidence: First, it cited a 2008 episode in which Johnson & Johnson tried to increase its price for a product but a hospital (Beijing Jishuitan Hospital) refused to pay the higher price and forced Johnson & Johnson to continue charging the old, lower price.[47] Second, Rainbow Medical submitted evidence showing that when it lowered its price for the Renmin Hospital bid, the price of competitors also decreased.[48]

The court viewed these facts as evidence supporting the conclusion that there was space for inter-brand price competition between Johnson & Johnson and its competitors but that competition was limited and weakened given Johnson & Johnson's leading market position. The court then determined that Johnson & Johnson's RPM contract enabled both Johnson & Johnson and its competitors to avoid price competition and maintain high prices. Finally, the court read the fact that Rainbow Medical was able to reduce its bids for supplying the Renmin Hospital, while still earning a reasonable profit, as evidence that the RPM contract had prevented efficient distributors from conducting inter-brand price competition.

Throughout the decision, the court viewed any episode of price competition between Johnson & Johnson and its competitors, or price concession by Johnson & Johnson for its customers, as evidence that there was "space" for inter-brand price competition. From an economic perspective, such events could also be interpreted as evidence that the market is competitive, i.e., competitors and buyers would respond to price movements by the defendant.

However, the court appeared to be of the opinion that Johnson & Johnson's RPM contract had prevented its distributors from reducing prices that would have led to price reductions by Johnson & Johnson's competitors and for its customers. Thus, in the court's view, the question of whether the RPM contract at issue was anticompetitive appeared to hinge on whether there was a pro-competitive reason for the defendant to limit its distributors' ability to reduce prices—the question next examined by the court.

When assessing whether the RPM contract had any pro-competitive effects, the court first identified a list of possible pro-competitive effects of RPM (as presented by the defendant), including preventing the "free-rider" problem among Johnson & Johnson's distributors, facilitating entry of new brands or new products, improving product quality and safety, protecting product reputation, providing consumers with uniform price information, helping with the development of distributors and distribution networks, and so on.[49] The court then concluded that the evidence did not support the claim that the RPM contract at issue generated any of the pro-competitive effects identified above, even though it recognized that a RPM contract could theoretically generate such effects.

First, the court determined, without citing any evidence, that given customers' familiarity with the products at issue, RPM contracts were not needed for protecting product reputation or

[47] *Id.* at 33.
[48] *Id.* at 33-34.
[49] *Id.* at 34.

providing consumers with uniform price information.[50] Again without citing any evidence, the court stated that it did not believe the development of distributors or distribution networks in this case necessarily benefited consumers. The court thus focused on the potential benefits of preventing the "free-rider" problem among Johnson & Johnson's distributors, facilitating entry of new brands or new products, and improving product quality and safety.

The court found that there was no evidence that the RPM contract at issue improved product quality and safety.[51] When Johnson & Johnson argued that the RPM contract helped to maintain its distributors' profitability and gave them incentives to provide better services, the court pointed out that Johnson & Johnson had not provided evidence that the product quality had improved as the result of the RPM contract. In other words, the court wanted evidence linking Johnson & Johnson's argument of possible effects in economic theory to facts in the real world. The court concluded that Johnson & Johnson had failed to provide such evidence.

The court also identified several reasons why the RPM contract in this case likely had little effect on product quality. For example, the court found that: (i) the product quality was primarily affected by Johnson & Johnson's own manufacturing and training of hospital staff, (ii) the RPM contract with distributors did not specify any role for the distributors that would affect product quality in a significant way, and (iii) there was little difference in product quality between J&J and its competitors.

Third, the court dismissed the defendant's argument that the RPM contract was needed to address the "free-rider" problem among Johnson & Johnson's distributors.[52] Based on Johnson & Johnson's contracts with its distributors, the court determined that, even without the RPM contract, Johnson & Johnson had very strict control over its distributors and thus a distributor would not be in a position to "steal" business from another distributor via "free-riding."

Fourth, the court determined that Johnson & Johnson did not need to use the RPM contract to help introduce new products into the relevant market.[53] The court's main evidence was that the defendant had been operating in China for 15 years and already had a strong reputation. Moreover, the court pointed out that the products at issue were introduced several years before the contract period and thus were no longer "new" products.

Finally, the court stated that Johnson & Johnson did not provide evidence for any other possible pro-competitive effects of the RPM contract at issue.[54]

Overall, comparing the evidence for possible anticompetitive effects with that for possible pro-competitive effects, the court found that there was stronger evidence to support the former and concluded the RPM contract at issue had a net anticompetitive effect. The court did consider economic testimony submitted by Johnson & Johnson's economic expert as well as that by Rainbow Medical's economic expert.[55] The court determined that while the testimony of

[50] *Id.*
[51] *Id.* at 34-35.
[52] *Id.* at 35.
[53] *Id.* at 35-36.
[54] *Id.* at 36.
[55] *Id.* at 36-37.

Johnson & Johnson's expert identified possible theoretical reasons why the RPM contract at issue may be pro-competitive, he failed to provide evidence to show that those theoretical effects were material in this case. The court was of the view that there should be better and more comprehensive economic evidence involving both theoretical and empirical evidence.[56] The significance of the court's statement is that, in future cases, the parties likely need to conduct economic analyses based on actual facts and empirical evidence to support their theoretical models.

V. CONSIDERATION OF ECONOMIC EVIDENCE RELATED TO DAMAGES

The appropriate damage in an AML case should be sufficient to redress the plaintiff's injury caused by the anticompetitive aspect of the defendant's monopolistic conduct.[57] Accordingly, the aggrieved AML plaintiff needs to prove that his interests would be served by enhanced competition in the market (redressibility), and that he/she was injured by the defendant's conduct to restrain competition in the market (causation).

Regarding "redressibility," Article 119 of the Civil Litigation Law provides the threshold that an AML plaintiff must satisfy. Article 119 requires that any plaintiff in a civil litigation have "a direct interest in the case."[58] This requirement is elastic and general. So long as the plaintiff asserts an injury of a type that the legislature sought to redress in providing a private remedy under Article 50 of the AML, the plaintiff should be deemed having "a direct interest in the case."

The language of Article 50 of the AML more directly indicates the legislature's intent that "redressibility" in AML cases should be construed as a mere threshold gatekeeper rather than a rigid hurdle. Article 50 requires that an AML defendant be liable for civil damages caused by his/her monopolistic conduct, and provides no particular requirement on the issue of plaintiff's standing.[59] Theoretically, any market participant or consumer who suffered harm, either directly or indirectly, caused by the defendant's monopolistic conduct should have standing to institute an AML lawsuit. This proposition is consistent with the "spirit" of the AML of preserving consumers' and public interests, because any negative impact of the defendant's AML violation would conceivably pass through the supply chain and eventually result in the harm to be borne by the ultimate consumers. Thus, granting AML standing to indirect victims, particularly consumers, could help to timely reveal and condemn AML violations as well as recover damages incurred by end consumers.

An additional factor is the causal link between the asserted anticompetitive injury and the monopolistic conduct. When presenting evidence to the court, the plaintiff should be able to specify his/her injury and to establish the proximity between his injury and the defendant's violation. The plaintiff should avoid including vaguely defined links in the chain of causation. The claimed injury should not be an indirect result of whatever harm may have been suffered by

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[56] *Id.* at 37.

[57] *See, e.g.*, Id. at 37-38.

[58] Civil Litigation Law of the People's Republic of China, [2007] Presidential Order No. 75, Oct. 28, 2007, as amended (last amendment in 2012), Art. 119.

[59] AML, Art. 50 ("If business operators implement monopolistic conduct and cause loss to others, the business operators shall be responsible for civil liabilities in accordance with the law.")

certain intermediate parties along the supply chain, in which case the intermediate parties would be entitled to the AML damages.

As there are only a limited number of AML decisions specifically discussing the damage issue in China, it may be valuable for the Chinese courts and future AML plaintiffs to get some implications from the U.S. jurisprudence on such issues. In the United States, the federal courts apply a five-factor test to "evaluate the plaintiff's harm, the alleged wrongdoing by the defendants, and the relationship between them to determine whether a plaintiff is a proper party to bring an antitrust claim."[60] These factors are: "(1) the nature of the plaintiff's alleged injury; that is, whether it was the type the antitrust laws were intended to forestall; (2) the directness of the injury; (3) the speculative measure of the harm; (4) the risk of duplicative recovery; and (5) the complexity in apportioning damages."[61] To some extent, the *Johnson & Johnson* court performed an analysis with several aspects similar to the factors listed above.

In *Johnson & Johnson*, while the court found Johnson & Johnson's RPM agreement at issue to be anticompetitive, it determined that most of the damages claimed by Rainbow Medical were not related to the anticompetitive conduct and hence should not be part of the damages considered under the AML.[62] As a result, the court reduced the plaintiff's damages claims of RMB 13,990,000 (about U.S.$2 million) to just RMB 500,000 (about U.S.$80,000).

In making this determination, the court took the following approach in considering economic and other evidence:

First, the court determined that the "but-for" world for calculating the damages should not be the profits that the plaintiff would have earned had it complied with the RPM contract at issue.[63] Rather, the court stated that the damages should only be the normal profits that the plaintiff would have earned in the relevant market during the relevant period. In other words, the court determined that the "but-for" world should be a world in which the alleged anticompetitive conduct was absent.

This is a logical conclusion—under the AML, the defendant should not be liable for both what would have happened if the plaintiff had followed the RPM contract (the anticompetitive effect claimed by the plaintiff and found by the court) and for what actually happened as the plaintiff did not follow the contract. If the RPM contract is ruled illegal, the relevant profits should be normal profits without the RPM contract.

With the "but-for" world being the market without the RPM agreement, the court dismissed the plaintiff's damages claims related to the scenario where the RPM agreement was implemented, e.g., loss due to high purchase prices (due to the need to buy the product from third party vendors), loss of anticipated profits, harm of business reputation, staff redundancy,

[60] *Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 535 (1983).

[61] *American Ad Mgmt., Inc. v. General Telephone of California*, 190 F.3d 1051, 1055 (9th Cir. 1999).

[62] *Johnson & Johnson*, at 37-38.

[63] *Id.* at 38.

loss due to overstocked products, loss of marketing expenses, etc.[64] The court also dismissed the plaintiff's claim of profit loss related to products not covered by the RPM agreement at issue.

To estimate the damages based on normal profits of companies in such a market, the court found that under the terminated contract between Rainbow Medical and Johnson & Johnson, the gross profit margin was about 23 percent. It then calculated that the margin for normal business should be 16 percent based on the fact that the defendant's price was about 15 percent above its competitors and that certain taxes and discounts should be deducted.[65]

However, it is not clear how exactly the court derived the 16 percent figure. Nonetheless, the court's ruling makes it clear that it is important for the plaintiff to submit economic and other evidence to show how its damages estimate is related to the conduct challenged under the AML. For example, one may consider an analysis of the price in a "but-for" world where the challenged conduct is absent.

VI. CONCLUSION

It is widely accepted among Chinese courts that AML claims should be based on sound economic principles and creditable economic evidence. This article provides a summary of the key issues considered by the courts in two AML cases and the judges' interpretations of economic evidence in disposing these issues. Since judges usually are not adequately trained in economics, the assistance by expert witnesses should become more important in future AML litigation in China. Accordingly, policy and appellate decisions should develop to encourage judges to use special expert opinions in complicated AML cases, and to guide judges to conduct appropriate economic analysis based on reliable economic evidence.

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[64] *Id.*

[65] *Id.* at 38-39.

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Geographic Market Definition in Chinese 2013 Antitrust Decisions — Inching Towards Convergence?

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Geographic Market Definition in Chinese 2013 Antitrust Decisions—Inching Towards Convergence?

David STALLIBRASS & Jing WEN[1]

I. INTRODUCTION

Antitrust activity in China stepped up a gear in 2013. While there was no increase in the number of merger decisions from previous years, there was a marked increase in the detail provided by the Ministry of Commerce ("MOFCOM") in the decisions they did make. Similarly, two landmark and lengthy court judgments in the *Rainbow v. Johnson & Johnson* and *Qihoo v. Tencent* cases provided new insight into antitrust analysis conducted by the courts. The decisions published in 2013 by the National Development and Reform Council ("NDRC") and the State Administration for Industry and Commerce ("SAIC") were less detailed, and are not analyzed in this paper.

Nonetheless, perhaps for the first time it is possible to attempt a comparative analysis of a single detailed element of antitrust decisions in China: the treatment of geographic market definition by MOFCOM and the Chinese courts in the year 2013.

Geographic market definition is often the less popular sibling of product market definition—it is given less attention in most discussions of competition economics, and shorter shrift in most administrative and judicial decisions, including in China. However, a country's policy in relation to geographic market definition is clearly of high importance both in the legal assessment of individual cases and in understanding extraterritorial reach and enforcement sophistication.

Part 2 of this paper summarizes China's formal guidance on geographic market definition and briefly sets it in an international context. Part 3 summarizes the approach to geographic market definition taken in all four merger decisions published in 2013 along with a select number of 2013 court cases. Part 4 provides an assessment, including a discussion of how China's approach to geographic market definition can be seen to have evolved in the years preceding 2013, and a brief discussion of four unpublished mergers that were cleared by MOFCOM during 2013. Part 5 concludes with some tentative projections for the future.

II. GUIDANCE ON GEOGRAPHIC MARKET DEFINITION

A. The Anti-Monopoly Law and Guidelines on Market Definition

The Anti-Monopoly Law ("AML") itself briefly defines a "relevant market" in Article 12:

> …the product scope and the geographical scope where business operators compete against each other for a specific product or service [ ] within a certain period of time.[2]

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Further detail is provided in the Guidelines on the Definition of the Relevant Market issued in July 2009 ("Guidelines"). The Guidelines are the only element of advisory clarification issued by the Anti-Monopoly Commission under the State Council and are applicable to all areas of antitrust enforcement and administration. Other rules and guidelines specific to antitrust process or assessment have been issued individually by the various administrative bodies responsible for enforcement or adjudication of antitrust issues, and do not have as universal an application.

The Guidelines define the purpose of market definition as "to specify the market scope within which business operators compete with each other."[3] The relevant geographic market is defined as "the geographic area within which buyers acquire the products that are relatively close substitutes" such that "relatively intense competition exists among these products, and in anti-monopoly enforcement, the area may be used as the geographic scope within which business operators compete with each other."[4]

The Guidelines go on to discuss how a relevant market may be defined, both in general and separately in relation to product and geographic markets.

When discussing the generalities of market definition, the Guidelines suggest a primary focus on evidence of demand-side substitution—if consumers view two products as close substitutes, then they are likely to be in the same market.[5] The Guidelines also discuss considerations of supply-side substitution, where firms are able to quickly change their means of production to enter a market or produce a product that they had not previously produced.[6] Where the relevant market is unclear, the Guidelines recommend recourse to the "hypothetical monopolist test" in order to determine whether two products or services are in the same market.[7]

When analyzing the geographic market, the Guidelines contain a relatively detailed list of considerations when assessing demand side substitution:

1. Evidence showing that buyers switch or consider switching to other geographic areas for purchasing a product due to the changes in product price or other competitive factors;

2. The product's transportation cost and transportation characteristics. In relation to the product price, the higher the transportation cost, the smaller the scope of the relevant geographic market is, such as in cases involving products like cement; the product's transportation characteristics will also determine the sales region, as in the case of industrial gases transported through pipelines;

3. The actual regions where the majority of buyers select their products, and the product distribution locations of the major business operators;

4. Regional trade barriers, such as tariffs, local administrative regulations, environmental protection factors, and technical factors. If a tariff is relatively high

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[2] Anti-Monopoly Law of the People's Republic of China, [2008] Presidential Order No. 68, Aug. 30, 2007.

[3] Guidelines on the Definition of the Relevant Market, [2009] Anti-Monopoly Commission under the State Council, May 24,

[4] *Id.*, article 3.

[5] *Id.*, articles 4 and 5.

[6] *Id.*, article 6

[7] *Id.*, article 7.

> compared to the product price, it is very likely that the relevant geographic market is a regional market; and
>
> 5. Other important factors. For instance, the preference of buyers in a specific geographic region, and the amount of products transported into and out of the geographic region.[8]

The Guidelines also provide suggestions for what to consider when conducting a supply-side analysis:

> any evidence that other business operators react to changes in competitive factors, such as product price; the promptness and feasibility of business operators in other areas to supply or distribute the relevant product, such as the costs associated with switching orders to business operators in other geographic areas.[9]

While it is helpful that the Guidelines list the factors to be considered, the Guidelines do not always provide assistance in how to interpret the individual factors or how to assess a situation where different factors appear to pull in different directions. As discussed below, when combined with the relative youth of the AML this lack of detail allows for inconsistency between geographic market definition decisions made by different agencies analyzing similar industries.

B. International Comparison

1. The United States

The most comparable American description of market definition can be found in the Horizontal Merger Guidelines jointly issued in 2010 by the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC").[10]

The Horizontal Merger Guidelines differ substantially from the Guidelines in China in not considering supply-side substitution in the assessment of the relevant market. Instead, they consider it in any subsequent analysis of competitive effect.

They also differ in making a distinction between geographic markets defined by the location of suppliers, and geographic markets defined by the location of consumers. When a geographic market is defined by the location of suppliers, then all the sales of all the suppliers in a geographic market are included in the calculation of the relevant entity's market share—even if the customers are located outside the geographic area. Conversely, when a geographic market is defined by the location of the consumer, then only the sales to consumers within the geographic market are included in calculations of market share, even if some of the selling entities are located outside of the geographic market.

The Horizontal Merger Guidelines in the United States suggest that defining a market by the location of suppliers is appropriate where consumers effectively travel to the factory or shop door in order to purchase goods or services. In turn, where goods or services are delivered to consumers at the consumers' location, such that the consumer is largely oblivious to the location of the supplier, then a market defined by the location of consumers is likely to be more

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[8] *Id*, article 9.

[9] *Id.*

[10] Horizontal Merger Guidelines issued by the U.S. Department of Justice and the Federal Trade Commission. August 19, 2010. http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf (accessed January 22, 2014).

appropriate.[11] In China, the Guidelines do not make this distinction, and by defining the geographic market as "the geographic area within which buyers acquire the products," it appears as though the Chinese Guidelines default to a consumer-focused geographic market.

A final, subtler, difference is in the evidence that the different sets of guidelines provide as examples. The Guidelines in China reference actual imports, exports, and regions of consumption, while the Horizontal Merger Guidelines in the United States focus more on consumer taste, business decisions, and actual barriers to trade, rather than observed trade patterns.[12]

In practice, where necessary the U.S. agencies conduct a very rigorous analysis of geographic market definition and the different competitive pressures within different regional markets. The 1997 merger between Office Depot and Staples was a landmark use of sophisticated economic analysis to determine the competitive constraint posed by two retail chains in hundreds of different regional markets.[13] More recently, when reviewing the proposed merger between American Airlines and United Airlines, the Federal Trade Commission analyzed the impact of the merger both on more than 1,000 air routes between particular city-pairs, and on take-off and landing slot concentration at a number of regional hubs.[14]

2. The European Union

The Directorate-General of Competition at the European Commission ("DG Comp") last published official guidelines on market definition in 1997.[15] In 2012, DG Comp took part in an OECD Round Table on market definition that affirmed the continued primacy of the 1997 guidelines, as amended by relevant case law.[16]

DG Comp's 1997 guidelines do not make the distinction between "supplier" and "consumer" focused geographic market definition that was introduced in the 2010 Horizontal Merger Guidelines in the United States. However they include supply-side substitution within the analysis, similar to the Guidelines in China.[17] However, the detailed description of how to assess geographic market definition differs.

The DG Comp guidelines suggest first establishing a tentative market definition by analyzing price and market share differences—where the differences in price and market share across regions presumably indicate different relevant markets. Demand characteristics, if possible based on reactions to changes in price, are then assessed to corroborate the initial market definition. If the answer is still inconclusive, then analysis of supply characteristics will be conducted. Supply characteristics include tariffs, the need for a distribution network, and

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[11] *Id*. at 4.2.

[12] *Id*.

[13] *Federal Trade Commission v. Staples, Inc. and Office Depot*, Inc. 970 F. Supp. 1066, 1070 (D.D.C. 1997).

[14] *See* http://www.justice.gov/opa/pr/2013/November/13-at-1202.html and http://www.justice.gov/atr/cases/f299900/299968.pdf (accessed January 22, 2014).

[15] European Commission notice on the definition of the relevant market for the purposes of community competition law, [1997] OJ C 372/3.

[16] OECD roundtable on market definition (2012). DAF/COMP(2012)19.

[17] European Commission notice, *supra* note 15, article 20.

regulatory barriers. Finally, and apparently as a last resort, the DG Comp guidelines suggest an analysis of historical trade flows.[18]

In practice, EU Member States, rather than DG Comp itself, deal with mergers which require detailed analysis of local geographic impact. In the United Kingdom, for example, a detailed practice has developed regarding definition of local geographic markets in retail mergers,[19] and recent merger investigations have assessed local markets in cinemas, construction aggregates, and air travel.[20]

3. Comparison

Table 1 below summarizes the key similarities and differences of the antitrust regimes in China, the United States, and the European Union, based on published guidance:

Table 1: Comparison of Chinese, U.S., and EU Guidance on Geographic Market Definition

	China	United States	European Union
Focus on demand substitution and potential use of hypothetical monopolist test	Yes	Yes	Yes
Include supply substitution	Yes	No	Yes
Make explicit differentiation between "consumer" and "supplier" defined markets	No	Yes	No
Suggested relevant evidence includes trade flows	Yes	No	As a final check
Suggested relevant evidence includes differences in market share and price across regions	Indirectly (where consumers purchase goods)	No	Yes

Each jurisdiction has a relatively similar headline framework that focuses primarily on demand substitution, and provides the "hypothetical monopolist test" as a potential method for determining the geographic market. However, beyond this, each jurisdiction differs in its guidance. On the basis of the published guidance alone it would not be surprising to see different decisions regarding the geographic market being reached in each jurisdiction.

[18] *Id.*, article 31.

[19] *See* http://www.oft.gov.uk/OFTwork/consultations/merger-inquiries#.UuHdyxCwqUk (accessed January 22, 2014).

[20] *See* http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/cineworld-city-screen, http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/breedon-aggregates-aggregate-industries and http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/ryanair-aer-lingus (accessed January22, 2014).

III. REVIEW OF KEY 2013 CASES

A continuing problem with detailed reviews of decisions by Chinese antitrust agencies is the relatively short length of most decisions. Where decisions are longer, such as in some court cases, it can still be hard to decipher the exact chain of analytical reasoning that underpins a particular conclusion. Nonetheless, 2013 was, to some extent, a watershed in terms of the detail and rigor of published decisions in China. All four published merger decisions of 2013 and three of the highest profile court cases of 2013 are discussed below.

A. Glencore/Xstrata

Glencore and Xstrata are both international mining, trading, and refining firms that overlapped in three product markets of concern: copper concentrate, zinc concentrate, and lead concentrate. In all three markets, the MOFCOM found the relevant geographic market to be worldwide. While the exact reasons behind this conclusion are not discussed in detail, the decision references the global nature of trade and production of the commodities. Since metal concentrates are commodities and largely undifferentiated, it is understandable that the decision does not appear to consider consumer tastes or demand-side substitution. Having identified the relevant market in which competition takes place as global, the decision then goes on to discuss the impact of the merger within China.[21]

The decision links the global market to the Chinese market by discussing the large share of global production of these commodities that is consumed within China, and by comparing the market shares of the two firms, both globally and in China. The decision thus discusses the effect of the merger on competition in the relevant global markets and the resulting impact on China. The sophistication of this approach is discussed in further detail in section 4.

B: Marubeni/Gavilon

Marubeni and Gavilon are also purchasers and traders of international commodities, in this case soybeans. However, despite the fact that, like metal concentrates, soybeans are produced and traded on a global stage, MOFCOM concluded that the relevant antitrust market was the market for importing soybeans into China, though "taking into consideration worldwide factors." This is a relatively novel market definition that eschews the traditional dichotomy between "global" and "national" and instead appears to define the relevant market as imports: the flow between the global and the national.[22]

The correct way to interpret this is probably as a Chinese geographic market for soybeans in which the price is set by imports. An alternative interpretation might be that the relevant geographic market is Mainland China and the relevant product is imported soybeans, though this would require imported and domestically produced soybeans to be differentiated products and there is no evidence that this is the case. Again, it appears as though soybeans are an undifferentiated commodity good.

The main factual difference between the *Marubeni/Gavilon* and *Glencore/Xstrata* cases, at least as inferred from the published decisions, is that a greater emphasis was placed on the

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[21] *Glencore/Xstrata*, [2013] MOFCOM Public Announcement No. 20, April 16, 2013.

[22] *Marubeni/Gavilon*, [2013] MOFCOM Public Announcement No. 22, April 22, 2013.

importance of a domestic distribution network in the case of *Marubeni/Gavilon*. In particular, the decision suggests that Marubeni had a powerful position in China as a result of its distribution network, and that Marubeni's acquisition of Gavilon would decrease the ability of global competitors to reach a sufficient scale with which they could credibly threaten to build a competing Chinese distribution network of their own. The strength and importance of the local distribution network may explain the adoption of a Chinese market definition.

By defining the market as "soybean imports," it appears that MOFCOM concluded that a competitive analysis of imports will suffice for determining the impact of the merger on the whole of the domestic market. However, under standard antitrust analysis, a focus only on a firm's share of imports does not accurately capture the likely impact of a merger. For a commodity like soybeans, a firm is only able to raise the price by decreasing the quantity of items they supply: less items are sold, but those that are still sold are sold for a higher price. Central to understanding whether or not a firm has an incentive to do this is how many items they sell at the prevailing price. Since both imported and domestically produced homogenous goods are usually sold for approximately the same market price, a firm with a large share of imports and no share of domestic production will have less incentive to constrain capacity and raise price than a firm of similar levels of import but with domestic production capacity as well. Focusing solely on imports ignores this.

For example, were Marubeni to have purchased a domestic producer of Chinese soybeans, then, under the proposed "import of soybeans" market definition, there would not have been a change in concentration and the merger may have been cleared. This could potentially be inconsistent with the objectives of the AML, since a merger between Marubeni and a domestic Chinese soybean producer would increase Marubeni's incentives to restrict imports into China—the post-merger entity would profit from the increased price on both the remaining sales of Marubeni beans but also the beans produced by the acquired Chinese supplier.

In the case of the merger between Marubeni and Gavilon, however, the competitive concern was that the merger would decrease competition in the global market and thus decrease the threat of entry, via imports, into the domestic market. Analysis of changes in domestic market share is probably not particularly relevant to their conclusions, and any lexical inconsistency in the definition of the relevant market is unlikely to have made an impact on the substantive decision.

C. Baxter/Gambro

Gambro and Baxter are producers of medical equipment and supplies that overlap in a single market of concern: continuous renal replacement therapy ("CRRT"). MOFCOM states in its public decision that it reviewed "tariffs, transport costs, import/export and trading conditions" in assessing the relevant geographic market, and concluded that the market was global. This is interesting, given the relatively high levels of country-specific regulation which MOFCOM's decision discusses: "every country has set market access restrictions for these products, and qualifications require the relevant products to meet certain technology and quality standards. The approval from China Food and Drug Administration must be obtained before one can engage in the relevant business in China."[23] MOFCOM did not state that it had analyzed consumer tastes.

Similar to the analysis in *Glencore/Xstrata*, MOFCOM made a clear distinction between the nexus of competition, which was global, and its analysis of the impact of the merger, which was particular to the China market. In line with this approach, the decision quotes market shares, market share changes, and HHI indices for both the global and Chinese market. The decision is almost written as if equal weight was given to competitive assessment from both a global and a Chinese perspective.

D. Mediatek/MStar

Mediatek and MStar are both designers of microchips for use primarily in consumer electronic devices. After analyzing "customs duties, transportation costs, import and export policies, trading volumes, product research and development, design procedures and industry distribution," MOFCOM concluded that the market for the relevant chips has "global features." However, since LCD TV control chips in particular need to be tailored to meet local technical and cultural requirements, MOFCOM held that, "when reviewing the global market," it is necessary to also focus on "assessing the situation in Mainland China." Again, similar to *Glencore/Xstrata* and *Baxter/Gambro*, MOFCOM adopted something of a hybrid geographic market definition that assesses the transaction's impact at both a global and a national level.[24]

E. Huawei v. InterDigital

The *Huawei v. InterDigital* case concerns private litigation between Huawei, a major Chinese manufacturer of consumer and business electronics, and InterDigital, a U.S. licensor of intellectual property largely related to mobile telecommunication devices. Huawei alleged that InterDigital had abused its dominant position in the ownership of a number of standard-essential patents. In particular, Huawei asserted that each standard-essential patent constituted a relevant product market on its own, and that each patent existed in at least the two independent geographic markets of China and the United States.

In 2013, two courts—the Shenzhen Intermediate People's Court and the Higher People's Court in Guangdong —agreed with Huawei's proposed geographic market definition. In particular, the courts agreed that a patent in the United States and a patent in China constituted separate markets, though in the case at hand the patents were being negotiated for license on a worldwide basis. The court decisions are not public, and no further detail is available as to how the courts reached these decisions.[25]

F. Rainbow v. Johnson & Johnson

Johnson & Johnson was involved in a dispute with Rainbow Medical Equipment about the resale of medical sutures in Beijing. The case was heard by both the Shanghai Intermediate

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[23] *Baxte /Gambro*, [2013]. MOFCOM Public Announcement No. 58, August 13, 2013.

[24] *Mediatek/Mstar*, [2013] MOFCOM Public Announcement No. 61, August 30, 2013.

[25] For a discussion of the case at first instance, which was upheld on appeal, *see* Ye Ruosi, Zhu Jianjun & Chen Wenquan, *Determination of Whether Abuse of Dominance by Standard Essential Patent Owners Constitutes Monopoly: Comments on the Antitrust Lawsuit Huawei v. InterDigital*, Electronic Intellectual Property No. 3 (2013).

People's Court and, on appeal, the High People's Court. The Shanghai High People's Court found that the geographic market was Mainland China, largely on account of import restrictions and regulations. However, despite formally defining the market as Mainland China, the court also referred to analysis of Johnson & Johnson's market position in Beijing, the region where the dispute took place.[26]

On the face of it, the conclusions of the Shanghai court and MOFCOM's decision in *Baxter/Gambro* are somewhat inconsistent. In *Baxter/Gambro*, the market was defined as global even though the products—continuous renal replacement therapy devices—are also medical equipment and, due to their complexity, are subject to regulation that is more onerous than mere sutures.[27] This difference in approach may have been due to the essentially local concern of the dispute between in *Rainbow v. Johnson & Johnson*, centering on Beijing.

In any event, and similar to the *Marubeni/Gavilon* decision, it is unlikely that either decision would have been substantially different were the formal market definition to have been different. In the *Baxter/Gambro* decision, the impact of the merger on both global and national competition was assessed, and the *Rainbow v. Johnson & Johnson* judgment concentrated on the choices available to hospitals in Beijing.

G. Qihoo v. Tencent

The *Qihoo v. Tencent* case concerns private litigation between Qihoo 360, the producer of China's most popular anti-virus software, and Tencent QQ, the producer of China's most popular instant messaging ("IM") software. Qihoo alleged that Tencent had abused a dominant position in market for use of IM software by Chinese consumers. Tencent argued that the relevant market was global since there were minimal trade or transportation barriers on the Internet. In turn, Qihoo argued that Chinese consumers had a very strong preference for Chinese IM products, noting that 95 percent of Chinese IM use was of Chinese IM products, while in comparison less than 1 percent of European IM use was of Chinese IM products.

The Guangdong High People's Court agreed with Tencent and found that, mainly due to the technical ease with which individual consumers could switch from IM products produced in China to IM products produced outside China, the relevant market was global.[28]

The conclusion of the Guangdong High People's Court is at odds with a 2009 decision regarding a dispute between two other Chinese internet companies, Baidu and Renren. In that decision, the relevant geographic market was defined as Chinese on account of strong national

[26] Shanghai High People's Court, *Bangrui Yonghe Technology Trading Co., Ltd. v. Johnson & Johnson (Shanghai) Medical Equipment Co., Ltd. and Johnson & Johnson Medical(China) Ltd.*, August 1, 2013, [2012] Hu Gao Min San (Zhi) Zhong Zi No. 6.

[27] Some sutures are a class II medical product, and other sutures, particularly absorbable sutures, are a class III medical product. All CRRT devices appear to be class III products (see http://www.sda.gov.cn/gyx02302/flml.htm, accessed January 22, 2014). Class III medical products are subject to national approval while class II products are subject to only provincial approval (http://www.sda.gov.cn/WS01/CL0784/16570.html, accessed January 22, 2014).

[28] Guandong High People's Court, Beijing Qihoo Technology Co. Ltd. v Tencent Technology (Shenzhen) Co. Ltd. and Shenzhen Tencent Calculation Systems Co. Ltd., March 20, 2013, [2011] Yue Gao Fa Min Chu Zi No. 2.

tastes.[29] Further, the conclusion also appears at odds with the focus on import restrictions seen in the *Rainbow v. Johnson & Johnson* case, since two of the most popular IM providers outside China, Facebook and Google+, are technically blocked by the "great firewall" of China.

H. Summary

The assessment of the relevant geographic market in the above decisions is summarized below:

Table 2: Geographic Market Assessments in 2013

Decision	Relevant geographic market	Factors considered in assessment
Glencore/Xstrata	Global. Impact analysis focused on China.	Global nature of trade and production of the commodities
Marubeni/Gavilon	Mainland China (imports into).	Importance of local distribution network.
Baxter/Gambro	Global. Impact analysis focused on China.	Tariffs, transport costs, import/export and trading conditions.
Mediatek/Mstar	Global. Impact analysis focused on China. Some suggestion of a China market for "TV controller chips."	Customs duties, transportation costs, import and export policies, trading volumes, product research and development, design procedures and industry distribution.
Huawei v. InterDigital	Separate markets for China and the US.	Unclear.
Rainbow v. Johnson & Johnson	Mainland China. Some suggestion of a focus on Beijing.	Government regulations.
Qihoo v. Tencent	Global.	Technical ease of consumer switching between suppliers from different regions.

IV. ASSESSMENT

We discuss three features of these decisions below: the extraterritorial reach of Chinese antitrust; the current technical sophistication of analysis; and whether the lack of geographic market definitions smaller than Mainland China in mergers is a result of the merger's notified to MOFCOM or the nature of MOFCOM's analysis.

A. Extraterritorial Reach

It is generally accepted that, under the "effects doctrine," antitrust law can have extraterritorial jurisdiction—if an action outside of a jurisdiction has an effect within that jurisdiction, then that action may come under the purview of the jurisdiction's law.

The *Marubeni/Gavilon* and *Glencore/Xstrata* mergers provide perhaps the clearest example of this principle in the short history of Chinese antitrust.

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[29] Beijing High People's Court, *Tangshan Renren Information Service Co. Ltd. v. Baidu Network Information Science and Technology Co. Ltd.*, July 9, 2010, [2010] Gao Min ZhongZi No. 489.

Gavilon exported only 400,000 tons of agricultural commodities into China, just 0.7 percent of the relevant market. The vast majority of Gavilon's operations were concentrated in the United States, outside of China. Despite this very small presence in the Chinese market, MOFCOM was concerned about the impact of the merger on potential future competition in China, and secured concessions to alleviate its concerns.

The concessions secured by MOFCOM in *Marubeni/Gavilon* concerned the behavior of the two firms, and were limited in time. The concessions sought by MOFCOM in the merger between Glencore and Xstrata were far more significant, involving the sale of a Peruvian copper mining interest called Las Bambas along with behavioral commitments relating to zinc and lead concentrate. Las Bambas is expected to be sold to a Chinese purchaser for a figure in the order of $5 billion, which represents about 10 percent of the value of Xstrata in the original transaction.[30]

MOFCOM was not the only competition authority to require concessions before allowing the Glencore/Xstrata deal to proceed. DG Comp also required divestment, but of assets related to zinc rather than copper.[31]

Taken together, the two cases—*Glencore/Xstrata* and *Marubeni/Gavilon*—show the broad extraterritorial reach of China's merger control and the substantive impact it can have on geographically distant business operations.

B. Sophistication of Analysis

In this section, we discuss the increasing sophistication of MOFCOM's market definition, and a level of inconsistency between some decisions.

1. Increasing sophistication of merger analysis

All the public 2013 merger decisions other than *Marubeni/Gavilon* adopted a global geographic market but concentrated their analysis on the impact in China. This dual approach appears consistent with both the Guidelines on the Definition of the Relevant Market, which often require defining the market as global, and the AML itself, which requires that mergers and conduct are assessed on the basis of their impact on the Chinese economy and consumers.

In effect, it appears as though the mergers were assessed on both a global and a domestic level, with problems being found in both markets. This may help explain why MOFCOM came to different substantive conclusions from the EU and U.S. authorities in all the mergers discussed above, despite adopting similar formal geographic market definitions in the three of them.

Table 3 suggests that, as MOFCOM has moved further towards assessing mergers with an international dimension, its confidence in explicitly stating both the geographic market definition and the analysis behind their reasoning has increased. Early decisions did not state the geographic market but were clearly focused on a domestic analysis. Subsequently, when decisions did start to state the geographic market, they provided no detail or explanation. In 2010 and for most of 2011, MOFCOM decisions continued to be vague about the exact nature of the geographic market, but provided some detail on the impact of the concentrations both within

[30] *See* http://online.wsj.com/news/articles/SB10001424052702304419104579322733991515544 (accessed January 22, 2014).

[31] Case COMP/M.6541 – *Glencore/Xstrata*, December 17, 2012.

China and globally, foreshadowing the dual approach apparent in 2013. The 2011 transaction involving General Electric and Shenhua was the first time MOFCOM referenced the factors that led the Authority to its geographic market conclusion, and most subsequent decisions also provided at least a cursory description of why a particular geographic market was selected.

Table 3: MOFCOM Geographic Market Decisions 2008 - 2013

Year	Merger	Product market	Geographic market	Notes
2008	Inbev /Anheuser-Busch	Beer	China	Implied
2009	Coca-Cola/Huiyuan	Soft drinks and juice	China	Implied
	Mitsubishi Rayon/ Lucite International	Polymers []	China	Stated, no discussion
	General Motors/Delphi	Automobile parts	China	Stated, no discussion
	Pfizer/Wyeth	Pharmaceutical drugs	China	Stated, no discussion
	Panasonic/Sanyo	Batteries	Unclear	No clear discussion. Perhaps implied global market.
2010	Novartis/Alcon	Contact lenses	Unclear	Discusses global and national shares.
2011	Uralkali/Silvinit	Potassium Chloride	Unclear	Discusses global and national shares.
	Alpha V/Salvio	Yarn cleaning	Unclear	Discusses global and national shares and imports.
	General Electric/Shenhua	Coal-water gasification	China	References consumer choice and business scope.
	Seagate/Samsung HDD	Hard disk drives	Global	References location of sales and supply contracts.
2012	Henkel/Tiande Chemicals	Ethyl cyanoacetate	Global	Stated, no discussion.
	Western Digital/Hitachi Storage	Hard disk drives	Global	References location of sales and supply contracts.
	Google/Motorola Mobility	Smart phones and operating systems	Global	Stated, no discussion.
	United Technologies/Goodrich	Airline AC generators and equipment	Global	References global sales and procurement strategies.
	Wal-Mart/Newheight	Grocery retailing	China	References consumption, transportation, and tariff factors.
	ARM/Giesecke & Devrieng/Gemalto	Security software and services	Unclear	No clear discussion. Perhaps implied global market.
2013	Glencore/Xstrata	Mineral concentrates	Global	See Table 2.
	Marubeni/Gavilon	Soybeans	China (imports into).	
	Baxter/Gambro	Renal therapy	Global	
	Mediatek/Mstar	Microprocessors	Global	

Despite the increased discussion of geographic market definition in published decisions, and the welcome move towards separating the definition of the geographic market and the geographic location in which impact is analyzed, the *Marubeni/Gavilon* decision of 2013 stands out as different. The process of analysis, linking a global change in market structure to the effect in China, is in line with other decisions, though the formal geographic market definition is both ambiguous and inconsistent with the developing MOFCOM practice.

2. Some inconsistency between decisions

The *Rainbow v. Johnson & Johnso*n decision by the Shanghai High People's Court was published on the August 1, 2013, and the *Baxter/Gambro* decision by MOFCOM close to two weeks later, on August 13, 2013. The analysis and drafting of the two decisions occurred at the same time and, in terms of market definition, they both focused on medical supplies subject to national regulations. The existence of these regulations led the Shanghai High People's Court to adopt a national geographic market definition, while MOFCOM adopted a global market definition despite the existence of Chinese national regulations that were more severe.

This divergence cannot be explained by differences in interpretation between the judiciary and administrative authorities. The existence of import restrictions on the internet that totally prevent access to major international IM providers did not stop the Guangdong High People's Court from finding that the relevant market was global in the *Qihoo v. Tencent* case. As discussed above, the decision also appears inconsistent with earlier court decisions regarding online geographic definition.[32] The *Qihoo v. Tencent* decision was appealed to the Supreme People's Court of China and oral arguments were heard in November 2013. A decision, expected in 2014, will hopefully clarify some of the confusion surrounding geographic market definition introduced by the earlier *Guangdong* judgment.

There may also be a slight inconsistency across time in the treatment of patents. Concerns in both the earlier 2012 *Google/Motorola Mobility* and *ARM/Giesecke&Devrient/Gemalto* mergers centered on the concentration of intellectual property and the relevant markets were defined as global. This is in some tension with the Shenzhen Intermediate People's Court decision in the 2013 *Huawei v. InterDigital* case that found that the United States and China constitute separate geographic markets for patents. However, this tension could perhaps be explained by the fact that the mergers involved firms producing downstream goods and services for which patents were an input, rather than involving firms whose sole and direct product was the intellectual property itself.

C. Market Definitions Smaller than Mainland China

Antitrust decisions and analysis in the United States and the European Union often dedicate substantial resources on assessment of competition in local markets. This is most common in mergers between retailers or service providers such as airlines that compete in multiple jurisdictions. However, even if firms produce goods available on a relatively universal basis across a given geographic area, where regional variations in consumer tastes are likely to be substantial, then consideration will be given to segmenting the geographic market further.

Antirust decisions in China have not adopted the same detail of analysis. Some earlier court decisions in private litigation have adopted single geographic markets smaller than

[32] The author acted as an expert witness in the trial, commissioned by Qihoo's instructing solicitor. For further discussion of geographic market definition, *see* http://www.concurrences.com/Bulletin/News-Issues/March-2013-I/Guangdong-High-Court-rules-against?lang=en (accessed January 22, 2014).

Mainland China, such as the *Huzhou Termite* judgment,[33] and some administrative decisions have also adopted narrower markets, such as *Guangdong GPS*.[34] However, it does not appear that multiple geographic markets within China have been analyzed independently. This is understandable, given the limited resources of the administrative authorities and the relative youth of the regime in general.

To determine whether MOFCOM's approach might have led to substantively different decisions, we have reviewed the list of 211 mergers that MOFCOM cleared without remedy in 2013 to determine if any of the cleared mergers appeared suitable for such a detailed analysis.[35] We found 4 mergers that, on the basis of the company names, either involved firms with overlapping distribution locations, such as stores fronts; involved geographically defined products, such as airline city-pairs; or involved products where consumer tastes are known to have strong geographic variation. Based on the relevant firms' press releases, annual reports, and marketing documents we discuss below whether the clearance of these four merges might be explained by a lack of detailed geographic market analysis.

1. Quantas/China Eastern JV

On January 25, 2013, MOFCOM cleared a joint venture ("JV"), Jetstar Hong Kong, between China Eastern Airlines and Quantas. Jetstar Hong Kong, based in Hong Kong, was to focus on short low-cost routes in Asia, including Greater China, Japan, and South East Asia. Prior to the JV, China Eastern and Quantas had operated code share agreements on a number of routes.[36]

Jetstar Airways, a wholly owned subsidiary of Qantas, had a strong presence in Asia, specifically in Singapore. China Eastern had a strong regional presence in Hong Kong, which Quantas also flies to. However, Jetstar and China Eastern did not overlap on any city-pairs. It therefore appears that the JV probably did not reduce actual competition on any particular city-pair. That said, the transaction may have affected potential competition and may also have led to a slight concentration in the control of landing and take-off slots at Hong Kong and Shanghai airports. It is not possible to say whether this constituted a sufficient reduction in competition to raise concern on a local level or not.

[33] Huzhou Intermediate People's Court, *Huzhou Yiting Termite Control Services Co., Ltd. v. Huzhou City Termite Control Research Institute Co., Ltd.*, [2009] Zhe Hang Zhu Chu Zi No. 553, June 7, 2010. Upheld on appeal by Zhejiang High People's Court, *Huzhou Yiting Termite Control Services Co., Ltd. v. Huzhou City Termite Control Research Institute Co., Ltd.*, [2010] Zhe Zhi Zhong Zi No. 125, August 27, 2010.

[34] *See* Decision in the Guangdong GPS case, July 27, 2011, http://www.saic.gov.cn/ywdt/gsyw/dfdt/xxb/201107/t20110727_111694.html (accessed January 22, 2014).

[35] *See* 2013 Q1 (45 in total): http://fldj.mofcom.gov.cn/article/zcfb/201304/20130400075697.shtml, 2013 Q2 (56): http://fldj.mofcom.gov.cn/article/zcfb/201307/20130700184718.shtml, 2013 Q3 (54): http://fldj.mofcom.gov.cn/article/zcfb/201310/20131000336357.shtml, and 2013 Q4 (56): http://fldj.mofcom.gov.cn/article/zcfb/201401/20140100457358.shtml (all accessed January 22, 2014).

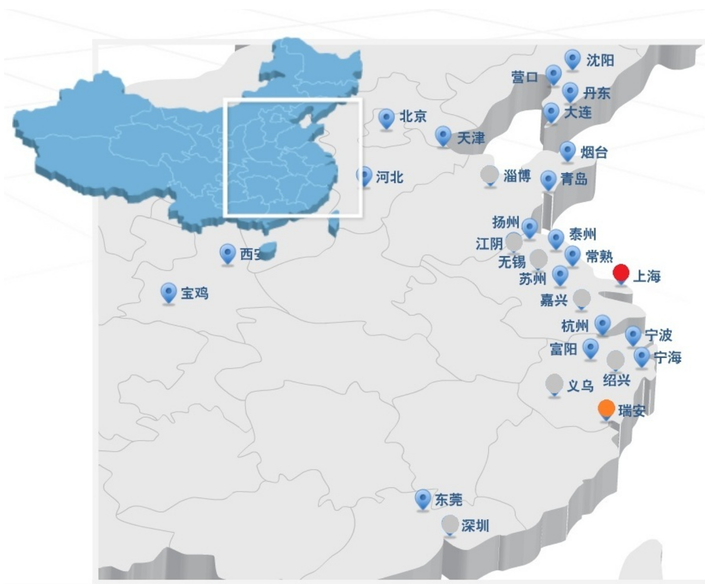
[36] *See* http://sky.news.sina.com.cn/2011-10-31/16426927.html and http://www.58jpiao.com/a/xinwenzixun/minhangxinwen/2010/1106/3079.html; and http://www.traveldaily.cn/article/66504.html (accessed January 22, 2014).

2. Baoxin Auto Group/Ruian Baolong Auto Sales/Shanghai Chen Long Autosales

On February 5, 2013, MOFCOM cleared a merger between Baoxin Auto Group, Ruian Baolong Auto Sales, and Shanghai Chen Long Auto Sales. This was a concentration between BMW dealerships on the east coast of China. An initial analysis of the physical locations of the relevant dealerships suggests that a localized analysis of market power may have raised concerns, though on a provincial or national level the changes in market share appeared to be small.

The map below, taken from the Baoxin Autogroup website, shows the location of their dealerships as of the end of 2013. The red marker is Shanghai where Baoxin previously operated a dealership and expanded their city-wide network by purchasing Shanghai Chen Long Auto Sales. This transaction increased the concentration of dealerships in Shanghai. The orange marker is Ruian where Baoxin did not previously own a dealership. This transaction did not increase the concentration of dealerships in Ruian—in fact, there is only one BMW dealership in Ruian—but it did increase concentration in Zhejiang province. The grey markets show dealerships owned by Baoxin Auto Group that did not sell BMW cars.

Figure 1: Map of Baoxin BMW Dealerships at End of 2013[37]



3. Snowbeer/Kingway and Carlsberg/Chongqing Brewery

During 2013, MOFCOM cleared two mergers between producers of alcoholic beverages. Consumer tastes for alcoholic drinks are often localized—in particular, consumers often have a strong preference for drinks that are locally brewed. As such, relatively modest changes in national market share can lead to relatively large changes in local market share, and thus raise competition concerns on a local level.

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[37] See http://www.klbaoxin.com/html/bus_network.php (accessed January 22, 2014), as amended by CRA.

On August 8, 2013, MOFCOM cleared the merger of CR Snowbeer and Kingway Brewery Holdings. Snowbeer is the Chinese market leader in beer and Kingway produces beers that are particularly popular in Southern China. SAB Miler stated in their press release that the merger would "reinforce…its market position in the fast growing Guangdong region, as well as providing additional scale and market presence in Sichuan, Shannxi, and Tianjin", clearly indicating the regional impact of the acquisition.[38] It is notable that Snowbeer may already have a 70 percent market share in Sichuan, as reported by an earlier 2007 press release.[39] Based on publicly available information it is possible that a geographic market definition narrower than mainland China may have led to concerns in at least some provinces.

On September 18, 2013, MOFCOM cleared the partial takeover by Carlsberg of Chongqing Brewery Company Limited. After the transaction, Carlsberg had a 60 percent stake in Chongqing Brewery, and consolidated the results of Chongqing Brewery into Carlsbergs annual accounts. Chongqing Brewery owns a large number of brewery assets around China, and has a market share as high as 85 percent in its home city of Chongqing.[40] Chongqing is a metropolitan region in the west of China with a population of around 35 million people. Carlsberg had been pursuing a strategy of expansion and acquisition in western China since 2003, and by 2006 already had a strong position in Chongqing as the number 2 premium beer brand.[41] Again, based on publicly available information it is possible that a geographic market definition narrower than mainland China may have led to concerns in at least some provinces.

4. Assessment

Since all four of the above cases were cleared, MOFCOM has not published its reasoning. It is thus not possible to determine whether the clearance decisions were the result of simply assuming a national market definition, potentially incorrectly; of checking for a local market definition but finding consumers and suppliers sufficiently flexible for a national market definition to be appropriate; or of assessing the impact of the mergers on local competition and finding no concern.

Regarding the JV between Quantas and China Eastern, publicly available information suggests that the potential increase in concentration was likely to be slight if anything at all, and the existing code-share agreements meant that the JV was also unlikely to create merger-specific increases in the potential for coordination. We conclude that it appears unlikely that the level of detail of geographic market analysis would materially influence the merger decision.

On the other hand, the substantive decision regarding the mergers involving Baoxin Auto Group, and *Snowbeer / Kingway* , and *Carlsberg / Chongqing Brewery*may well be sensitive to the granularity of the geographic market adopted. Perhaps as time progresses, more detail will be published on cleared mergers and a better understanding of MOFCOM's approach to geographic market definition can be established.

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[38] See http://www.sabmiller.com/index.asp?pageid=149&newsid=2122, accessed at 24th January 2014.

[39] See http://www.cre.com.hk/press/R20070104-e.pdf, accessed at 24th January 2014.

[40] See http://www.carlsberggroup.com/investor/news/Pages/SEA_11122013_Chongqing.aspx#.UuyOhhCSw7s, accessed at 24th Jaunary 2014.

[41] See http://www.carlsberggroup.com/investor/downloadcentre/Documents/Other%20Presentations/27.11.06%20Carlsberg%20in%20China%20.pdf (accessed at 24th January 2014).

V. CONCLUSION

2013 was a landmark year for Chinese antitrust with unprecedented levels of detail provided by the decisions of courts and administrative authorities. This transparency has allowed a relatively detailed assessment of the geographic market definition decisions made during the year, but has also shown some inconsistencies and lacunas in analysis:

- All four merger decisions show that MOFCOM takes a relatively sophisticated and flexible approach to geographic market definition, analyzing the linkages between the defined geographic market and also spheres of geographic competition that are both larger and smaller. This "hybrid" or "dual" approach is largely consistent with the objective of the AML and the Guidelines.
- There remains a lack of clarity in merger decisions in commodity markets about whether the geographic market will be defined locally with changes to global competition considered as an input to the local analysis, as in the case of *Glencore/Xstrata* and *Marubeni/Gavilon*; or whether it will be defined globally with a specific focus on the impact on China. In 2013, this lack of clarity did not appear to affect the substantive decisions, but it poses some uncertainty for the future.
- There also remains a lack of clarity over the importance of import restrictions and regulations. MOFCOM's decision in *Baxter/Gambro* and the Guangdong High People's Court's decision in *Qihoo v. Tencent* did not appear to put particular weight on such restrictions. The Shanghai High People's Court's s decision in *Rainbow v. Johnson & Johnson* did, even though the restrictions were arguably less strong than in the other cases.

Looking ahead to 2014, we make the following predictions:

- MOFCOM will continue its hybrid approach of assessing the competitive impact on multiple geographic levels.
- MOFCOM may consider conducting more detailed geographic market definition analysis, perhaps focusing more on variations in consumer taste, if a suitable case presents itself and internal resources are available.
- Decisions by the Supreme People's Court in the ongoing litigation between Qihoo and Tencent will shine more light on the importance of (i) differences in consumer tastes and (ii) import restrictions on the definition of the relevant market.

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Combating Monopoly Agreements Under China's Anti-Monopoly Law: Recent Developments and Challenges

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Combating Monopoly Agreements Under China's Anti-Monopoly Law: Recent Developments and Challenges

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I. INTRODUCTION

Five years after China's Anti-Monopoly Law ("AML") took effect, enforcement efforts of the antitrust agencies against restrictive agreements—called "monopoly agreements" in the AML—visibly picked up during 2013. This paper reviews recent developments, identifies a few key issues, and provides some suggestions for China to further improve its antitrust enforcement.

II. PROHIBITION OF MONOPOLY AGREEMENTS

The AML prohibits two types of monopoly agreements. Article 13 of the AML outlaws the following horizontal agreements: price-fixing, output or sales restrictions, market partitioning, agreements that restrict the purchase or development of new technology or new products, and joint boycotts. Article 14 of the AML prohibits types of vertical agreements, especially the setting resale prices or minimum resale prices to a third party. Both Article 13 and Article 14 contain a "catch-all" provision, which states that companies shall not reach other monopoly agreements as determined by the antitrust authorities.

Article 15 of the AML contains exemptions for those monopoly agreements that have the following purposes: R&D, improving product quality, standard-setting, environmental protection, enhancing competitiveness of small and medium-sized enterprises, among others. Crisis cartels and exporting cartels are also exempted. Companies wishing to benefit from the exemptions must prove that the agreement does not substantially restrict competition in the relevant market but enables consumers to share benefits deriving from the agreement.

Article 16 of the AML specifically provides that no trade association may organize conduct for the enterprises in its industry that is prohibited by monopoly agreement rules.

As a unique feature of China's antitrust enforcement structure, the monopoly agreements provisions in the AML are enforced by two separate agencies: The National Development and Reform Commission ("NDRC") is responsible for tackling price-related monopoly agreements, and the State Administration for Industry and Commerce ("SAIC") is responsible for non-price-related monopoly agreements.

Sanctions against monopoly agreements include a fine of 1 to 10 percent of the sales revenue in the previous year, plus confiscation of illegal gains. Where the concluded monopoly agreement has not been implemented, a fine of up to RMB 500,000 million (approximately U.S.$80,000) may be imposed. Violations by trade associations can be sanctioned with a fine not exceeding RMB 500,000, or lead to suspension of the association's registration.

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In line with international best practice, the AML also introduced a leniency program, albeit in very general terms: "If business operators report information concerning the conclusion of a monopoly agreement and provide important evidence to the anti-monopoly enforcement authority on their own initiative, they may be given a mitigated penalty or be granted immunity.

To provide more guidance, NDRC issued its *Anti-Price Monopoly Regulation* on December 29, 2010.[2] Consisting of 29 articles, this set of substantive rules specifies the scope of price monopoly activities, the specific forms of monopoly agreements that constitute price monopoly, the specific forms of abuse of dominance that amount to price monopoly, and what specific circumstances can be accepted as justification for engaging in these activities. NDRC also issued its *Regulation on the Administrative Enforcement Procedure for Anti-Price Monopoly* on the same day.[3] These procedural regulations contain 26 provisions and specify competence of NDRC and price authorities at the provincial level, the working relationship between NDRC and the provincial authorities, and the measures for conducting investigations. Both sets of rules took effect on February 1, 2011.

Similarly, SAIC issued its *Regulation on the Prohibition of Monopoly Agreement Conduct*, just two days later, on December 31, 2010.[4] This regulation contains 20 articles, and focuses on the definition and specific forms of monopoly agreements, and the conduct of trade associations that may facilitate monopoly agreements. It also details a leniency system that is designed to encourage active reporting of monopoly agreements by cartel participants—SAIC had already introduced its leniency program in 2009 in the *Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position*.[5]

While there is still room for improvement, these NDRC and SAIC regulations to implement the AML provide further guidance on the law's relatively high-level provisions regarding monopoly agreements. This helps enhance transparency, and increases the efficiency of antitrust enforcement in China.

III. RECENT ENFORCEMENT EFFORTS AGAINST MONOPOLY AGREEMENTS

Prior to 2012, the number of AML cases dealt with by NDRC and SAIC was relatively small. However, the number has increased significantly in recent years. Based on publicly available information, the two enforcement agencies have completed investigations of 22 monopoly agreements since 2010.

NDRC and SAIC visibly increased their enforcement efforts in the monopoly agreement area in 2013. During that year, NDRC investigated and imposed fines in five monopoly agreement cases:

- LCD panel price-fixing,

[2] Anti-Price Monopoly Regulation, [2010] NDRC Order No. 7, December 29, 2010.

[3] Regulation on the Administrative Enforcement Procedure for Anti-Price Monopoly, [2010] NDRC Order No. 8, December 29, 2010.

[4] Regulation on the Prohibition of Monopoly Agreement Conduct, [2010] SAIC Order No. 53, December 31, 2010.

[5] Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position, [2009] SAIC Order No. 42, June 5, 2009.

- Maotai and Wuliangye's resale price maintenance ("RPM") for Chinese liquor,
- Xinjiang insurance price monopoly agreement,
- infant milk formula RPM, and
- the monopoly agreement by the Shanghai Gold & Jewelry Trade Association.

The three cases investigated and closed by SAIC during 2013 are the Zhejiang Cixi construction project verification monopoly agreement, the monopoly agreement by the Sichuan Yibin Construction Brick & Tile Association, and the monopoly agreement by the Yunnan Xishaungbanna Tourism Association.

Overall, by the fifth anniversary of the AML's entry into effect—August 2013—China's enforcement efforts against monopoly agreements had become noticeably rigorous, covering such sectors as construction, energy, tourism, insurance, electronics, the used car market, and food. Among the 22 cases investigated and closed by NDRC and SAIC since 2010, 18 were horizontal agreements, and four were vertical agreements (including the Maotai and Wuliangye *White liquor* cases where the key issues were RPM and territorial restrictions, and the *Baby milk formula* RPM case).

In terms of penalties, the heaviest fine NDRC imposed on monopoly agreements under the AML occurred in 2013. In particular, on August 7, 2013, NDRC issued the record fine of RMB 670 million (approximately U.S.$110 million) on six infant milk powder companies, including Mead Johnson Nutrition, Danone, Fonterra, Abbott Laboratories, FrieslandCampina, and Biostime International, for engaging in RPM and attempted fixing of retail prices for infant milk powder.

A number of monopoly agreement violations investigated by NDRC and SAIC involved and, in fact, were facilitated by trade associations. Among the 22 cases mentioned above, 14 involved trade associations. The first antitrust fine imposed on trade associations under the AML had been issued in the *Pre-mixed concrete* case in Lianyungang in 2010, in the amount of RMB 200,000 (around U.S.$32,000). A more recent case was the Shanghai Gold & Jewelry Trade Association case. On August 13, 2013, NDRC issued a decision imposing fines of more than RMB 10 million (approximately U.S.$1.6 million) upon the Shanghai Gold & Jewelry Trade Association and five Shanghai gold retailers. The five retailers were Shanghai Laofengxiang, Laomiao Gold, Firstasia Gold, Chenghuang Jewelry, and Tianbao Longfeng. According to NDRC's investigation, the gold and jewelry prices in these gold shops remained at the same level, supervised under the auspices of the Shanghai Gold & Jewelry Trade Association.[6]

Recent AML enforcement has also underscored the effectiveness of China's leniency programs as a weapon to combat monopoly agreements. For example, the *Sea sand* case in Guangdong involved more than 20 companies that had organized a series of secret meetings to coordinate the price of sea sand starting in November 2010. According to NDRC, the companies were fully aware that they were breaking the law and took steps to conceal their actions.

[6] *See* Xinhua, *Shanghai gold retailers fined over monopoly*, August 13, 2013, *available at* http://news.xinhuanet.com/english/china/2013-08/13/c_132626003.htm (last visited on January 9, 2014).

The increase in the price of sea sand affected the price of concrete and, subsequently, the cost of several ongoing construction projects, including the Hong Kong-Zhuhai-Macau Bridge. This attracted the attention of, first, the government of Guangdong province, and then NDRC. As the authorities initially encountered difficulties in investigating the cartel, they targeted six core members and used the leniency program to obtain essential evidence, including the names of the participants and the text messages exchanged between them. Fines were imposed on three of the cartel participants, two of whom were identified as organizers of the cartel and the third being the primary beneficiary of the cartel. One of the two "ringleaders" saw its fine reduced by 50 percent for voluntarily providing important evidence to the authorities under the leniency program. The other two companies each received the maximum fine permitted under the AML—10 percent of the preceding year's sales revenue. Other participants received a warning but were not subject to a monetary penalty.[7]

In the *Baby milk formula* case, NDRC also applied the leniency program. Three companies involved in the same case—Nestlé, Meiji, and Zhejiang Beingmate Scientific Technology Industry &Trade—were not punished because they cooperated with the investigators, provided important evidence, and carried out active "self-rectification." The other six companies were fined, heavily, as mentioned above.

IV. INTERESTING ISSUES REFLECTED IN KEY CASES

A. More Guidance Is Needed on Standards of Legality

Chapter 2 of the AML covers both horizontal and vertical monopoly agreements. The language of the AML does not specify explicitly whether the *per se* rule or the rule of reason applies to either horizontal or vertical agreements (or both). On the one hand, Article 13—governing horizontal agreements—prohibits "hard-core cartels" such as price-fixing, setting output/sales quota, and market partitioning, which are mostly treated under the *per se* rule by international standards. On the other hand, Article 15 provides that even hard-core cartels can be exempted for a number of reasons; for example, to cope with recessions or to promote exports.

Of NDRC's and SAIC's 18 closed horizontal cases, all were hard-core cartel agreements and none seemed to fall into the exemption category of recession or export cartels. In addition, all cases seem to be dealt with by the *per se* rule. Further, with one exception, there has not been any information made public that indicates the cartel members engaged in an affirmative defense of their conduct. The exception is NDRC's investigation of the Liaoning cement association price-fixing case in 2012.[8] With these cases being examined under a *per se* rule approach, this is a good sign that China's antitrust enforcement against cartels is consistent with international best practice.

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[7] Information about NDRC's investigation can be found at NDRC website at http://www.sdpc.gov.cn/zjgx/t20121026_510843.htm (last visited on January 9, 2014). *Also see China's NDRC Uses Leniency Program to Uncover and Punish Members of Cartel, available at* http://www.mondaq.com/unitedstates/x/210306/Antitrust+Competition/UK+Supreme+Court+Issues+First+Antitrust+Ruling (last visited on January 9, 2014).

[8] In this case, NDRC considered such factors as the presence of excessive capacity in the sector and ruled that the agreement was not illegal. *See*, e.g., http://info.ccement.com/news/content/4182375948569.html, last visited on February 6, 2014.

On vertical agreements, the AML specifically singles out just two types of illegal agreements: setting the resale prices, or minimum resale prices, to a third party—in other words, resale price maintenance ("RPM"). Three of the four vertical agreements investigated and closed by NDRC (the *Maotai*, *Wuliangye*, and the *Baby milk formula* cases) were violations of the RPM prohibition.

Although these three cases created nation-wide attention in China, it is still not clear whether a *per se* rule or the rule of reason applies to vertical agreements such as RPM—even after five years of enforcement since the AML went into effect. In fact, in the *Maotai* and *Wuliangye* cases, the final AML violation decisions issued by the local NDRC offices seem to have adopted different rules toward RPM.

In the first instance, the Price Bureau in Guizhou Province in the Maotai case stated in its decision that "Maotai had imposed minimum retail prices in its contracts with its distributors, and imposed penalty on those distributors not obeying the minimum retail price, thus violating Article 14 of the AML, and eliminating and restricting competition, and harming consumer welfare." There was no further elaboration on how the Bureau reached its decision.[9] The Baby milk formula RPM case also seemed to be dealt with in a similar way by NDRC.[10]

However, in the *Wuliangye* case, the official statement published by NDRC office in Sichuan Province pointed out that Wuliangye used its "market strength" to fix the minimum resale price. It found that such behavior violated Article 14 of the AML, as it restricted competition and damaged the interests of consumers. To support this finding, NDRC's Sichuan office further analyzed various anticompetitive effects arising from Wuliangye's conduct, referring to restrictions to both intra-brand and inter-brand competition. Also, the NDRC office held that Wuliangye's conduct damaged consumer welfare as it impaired the consumer's right to buy products at a lower price. The regulator also found that the degree of substitutability of Wuliangye's liquors was low.

The decision of the Sichuan NDRC office is consistent with the rule of reason approach established in the United States where the U.S. Supreme Court established the rule of reason approach for RPM in its *Leegin* decision, after decades of academic and legal debates. The Sichuan decision is also consistent with the decision in the *Rainbow v. Johnson & Johnson* case by a Shanghai court in 2013.[11]

Based on their cases to date, it would be sensible for NDRC and SAIC to explicitly establish a rule of reason approach toward vertical agreements such as RPM, especially in light of the decisions regarding *Maotai* and *Wuliangye* cases.

Similarly, the 18 horizontal agreements fined by NDRC and SAIC so far seem to have been adjudicated under the *per se* rule approach. Based on these decisions, and consistent with

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[9] The official decision (in Chinese) can be found at http://finance.21cn.com/news/macro/a/2013/0222/16/20446945.shtml, last visited on January 9, 2014.

[10] *See* http://news.xinhuanet.com/fortune/2013-08/07/c_116846276.htm, last visited on February 6, 2014.

[11] Shanghai High People's Court, *Bangrui Yonghe Technology Trading Co., Ltd. v. Johnson & Johnson (Shanghai) Medical Equipment Co., Ltd. and Johnson & Johnson Medical (China) Ltd.*, August 1, 2013, [2012] Hu Gao Min San (Zhi) Zhong Zi No. 6.

international standards, it would be appropriate for NDRC and SAIC to explicitly announce that the *per se* rule applies to those hard-core cartels that are neither recession nor export cartels (so as to be consistent with Article 15 of the AML).

B. High Level of Trade Associations Involvement

An important feature of the monopoly agreements that have been uncovered and fined by NDRC and SAIC is the high level of involvement of trade associations. In particular, in 14 of the 18 horizontal monopoly cases closed by the two agencies as of 2013, trade associations acted as organizers of the illegal agreements. These cases include the pre-mixed concrete cartel case in Lianyungang, price-fixing by the Fuyang Paper Association, the monopoly agreement by the Xishuangbanna Tourism Association in Yunnan, and the Shanghai Gold & Jewelry Trade Association case.

Frequent involvement of trade associations in monopoly agreement cases in China may be caused by several reasons. The first reason—which may be relatively easy to overcome—is that many trade associations in China were, and still are, unaware of the existence of the AML. Influenced by the traditional central-planning way of reasoning, some trade associations still consider coordinating activity by, and helping organize monopoly agreements among, firms in their respective sectors as their "duty." Some trade associations publically promote coordination among firms, and even push the firms to follow their "self-regulations." In some cases, trade associations have even pushed members to sign written agreements or meeting minutes.[12] The Pre-mixed concrete and Shanghai Gold & Jewelry Trade Association cases belong to this category. In the Shanghai case, the trade association was even blaming the NDRC staff for interfering with their normal duties.[13]

The second possible reason for Chinese trade associations to engage in anticompetitive practices is the insufficient deterrence effect of the AML towards conduct by trade associations. While Article 16 of the AML specifically provides that trade associations shall not engage in anticompetitive conduct, the maximum penalty applicable for violations by trade associations is only RMB 500,000.

Consistent with international standards, the AML prohibits anticompetitive conduct by trade associations as well as by business operators. Monopoly agreements organized or facilitated by trade associations have the same competitive effects as agreements reached by companies directly. One could even go further and argue that monopoly agreements, especially cartels, reached by trade associations are more detrimental to competition—trade associations may be able to provide more effective channels for businesses to communicate, achieve, and enforce cartel agreements. In addition, cartels facilitated by trade associations cause more damage to "competition culture" compared to cartels organized (secretly) by some, but not all, firms in the relevant sector.

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[12] *See* Clare Gaofen Ye, *The Anti-monopoly Regulation of the Monopoly Agreements in China*, REPORT ON COMPETITION LAW AND POLICY OF CHINA 2011, Ch. 2 (2011) and http://news.xinhuanet.com/fortune/2008-07/31/content_8883762.htm, last visited on February 6, 2014.

[13] *See* NDRC website at http://jjs.ndrc.gov.cn/gzdt/t20130813_553441.htm (last visited on January 9, 2014).

Based on the above considerations—including the observed high frequency of AML violations by trade associations—I am of the view that the legal consequences for AML violations by trade associations are not severe enough and should be strengthened.

It is striking to see that many trade associations in China are still unaware of the AML and instead regard their cartel-facilitating services as contributing to the healthy development of their sectors—even five years after the AML took effect. Judging from the cases, such ignorance even exists among trade associations in China's economic and financial center, Shanghai. It is thus imperative for China's enforcement agencies, including the Anti-Monopoly Commission, to increase their efforts in competition advocacy and promote a culture of fair competition and educate the business community.

Furthermore, the antitrust authorities should be more transparent about closed cases. This would increase competition awareness within the business community, particularly by trade associations, and would thus enhance the deterrence effect of the AML. The business community would understand better the legal and economic reasoning of the agencies in their decisions,[14]helping reduce legal uncertainty. Such awareness, in turn, would help reduce the number of cartels organized by trade associations, and thus lead to great benefits for consumers in China.

C. Effectiveness of and Consistency Between Leniency Programs

In China, leniency programs have played an important role in NDRC's detecting antimonopoly violations; for example, for the cartel activities in the *Sea sand* and *LCD panel* cases and RPM conduct in the *Baby milk formula* case. SAIC, by contrast, has not yet applied the leniency program as stipulated in the *Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position.*

It is interesting to note that there are several important differences between the two leniency programs of NDRC and SAIC as applied to their respective responsibilities, namely price-monopoly agreements for NDRC and non-price monopoly agreements for SAIC:

- First, "organizers of monopoly agreements" do not qualify for exemption or fine reduction under SAIC's leniency program.[15] By contrast, there is no such restriction in NDRC's leniency program. In fact, in the *Sea sand* case in Guangdong, NDRC showed that even organizers/leaders of cartel agreements can enjoy partial immunity—one of the three organizers was given a 50 percent reduction in the fine. (The other two organizers were imposed the maximum fine level under the AML, namely 10 percent of the sales revenues in the preceding year.)
- Second, the NDRC leniency program stipulates that the first firm that comes forward with important evidence "may" enjoy full immunity and the fine for the second whistle-

[14] In this regard, SAIC has done a better job in that its official announcements of the 12 monopoly agreements cases were much more comprehensive and detailed.

[15] Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position, [2009] SAIC Order No. 42, June 5, 2009, Art. 10.

blower "may be" reduced by up to 50 percent.[16] By contrast, SAIC's leniency program provides more certainty by stipulating that "full immunity will be granted" to the first whistle-blower to provide the authority with relevant information and important evidence.[17]

It may be argued that granting (even partial) immunity to organizers of a cartel may be "injustice" and, hence, SAIC's leniency program is fairer. However, NDRC's leniency program may be more effective in detecting a monopoly agreement by inducing the "ring leader" to come forward. If SAIC's leniency program had been applied in the *Sea sand* case, the organizer might not have come forward to provide important evidence to NDRC and the cartel might not have been detected as easily.

The second difference between the two authorities' leniency programs reveals that SAIC's program is "more lenient" in that it grants full immunity to the first whistle-blower and hence provides certainty (unless the first whistle-blower was the organizer of the monopoly agreement). In contrast, there is some degree of uncertainty as to whether a fine reduction can be obtained under NDRC's leniency program. This uncertainty may discourage participants in a monopoly agreement from coming forward with evidence. Considering these two differences, it is not clear which leniency program is more effective.[18]

In any event, the inconsistency between the two agencies' leniency programs creates uncertainty about the rules, and contrasts with international standards for using leniency programs to combat cartels. [19] A revision of the two agencies' leniency programs to set a uniform policy seems justified.

Finally, another interesting observation is that NDRC has applied its leniency program to vertical monopoly agreements, as seen in the *Baby milk formula* case. This extension of leniency program to vertical agreements is not common in antitrust practices outside China.

V. CONCLUDING REMARKS

Several interesting patterns have emerged from the increasing antitrust enforcement efforts by NDRC and SAIC, in particular during 2013. For example, trade associations have played an important role in facilitating horizontal monopoly agreements; this was the case in 14 out of the 18 such agreements fined by the two agencies as of the end of 2013. Also, NDRC has applied its leniency program both to horizontal agreements (for example, in the *Sea sand* case) and, interestingly, vertical agreements (in the *Baby milk formula* case).

China's antitrust enforcement can be further improved with clear(er) legal standards towards vertical agreements, heavier penalties for AML violations by trade associations, as well as

[16] Regulation on the Administrative Enforcement Procedure for Anti-Price Monopoly, [2010] NDRC Order No. 8, December 29, 2010, Art 14.

[17] Regulation on the Procedure for the Handling of Cases Involving Monopoly Agreements and Abuses of a Dominant Market Position, [2009] SAIC Order No. 42, June 5, 2009, Art. 11.

[18] It is conceivable that the self-reporting organizer of the Guangdong Sea Sand price-fixing case was assured by NDRC staff of getting a fine reduction conditional upon providing evidence during the investigation.

[19] *See*, e.g., INTERNATIONAL COMPETITION NETWORK, ANTI-CARTEL ENFORCEMENT MANUAL (2009).

better competition advocacy and increased transparency. A unified leniency program based on the existing leniency policies of NDRC and SAIC is also desirable.

Moreover, the separation of enforcement duties for price and non-price monopoly agreements between NDRC and SAIC has been criticized by many,[20] as the separation increases the risks of inconsistency in AML enforcement. Indeed, a monopoly agreement may have both pricing and non-pricing dimensions, in which case cooperation between NDRC and SAIC is necessary.[21] To avoid the dilemma of contrasting decisions, the two agencies should set up an effective cooperation mechanism that includes an information/file exchange. It may also make sense for the agencies to set up project-based task-force groups that would help identify potential complementary expertise between their officials and facilitate effective cooperation on a case-by-case basis.

[20] *See*, e.g., Wang, Xiaoye, ANTI-MONOPOLY LAW at 333-335 (2011); Allan Fels, *China's Antimonopoly Law 2008: An Overview*, 41(7) REV. INDUS. ORG., 7–30 (2012), and Angela Huyue Zhang, *The Enforcement of the Anti-Monopoly Law in China: An Institutional Design Perspective*, 56 ANTITRUST BULL. 630-663 (2011).

[21] Such a situation arose in the Liaoning Cement Trade Association 2012 case, which involved both price-fixing and output restrictions. Both NDRC and SAIC investigated the same facts but reached different decisions. SAIC found the output restriction arrangement to violate the AML, but NDRC held that the same restriction did not constitute monopoly conduct. *See* SAIC website: http://www.saic.gov.cn/zwgk/gggs/jzzf/201307/t20130726_136746.html, last visited on February 6, 2014, and http://info.ccement.com/news/content/4182375948569.html, lasted visited on February 6, 2014. Also see Clare Gaofen Ye, *The Anti-monopoly Regulation of the Monopoly Agreements in China*, REPORT ON COMPETITION LAW AND POLICY OF CHINA 2013 (2013).