SLAUGHTER AND MAY

Competition Law in China

JANUARY 2015
1. Introduction

The People’s Republic of China ("PRC") has a comprehensive system of competition law under its Anti-Monopoly Law ("AML") which came into effect on 1 August 2008. It applies throughout the PRC with the exception of the two Special Administrative Regions of Hong Kong and Macau.\(^1\)

The AML prohibits "monopolistic conduct", which can be divided into the following broad headings:\(^2\)

(i) Anti-competitive ("monopoly") agreements between undertakings;

(ii) Abuse of a dominant position; and

(iii) Mergers that may have the effect of eliminating or restricting competition.

In addition to the AML itself, implementing rules and guidelines play a crucial role in the application of the AML. However, limited guidance is available and there remain areas of uncertainty over the application of the AML. Reliance is placed on the practice of the authorities, which may change from time to time.

Whilst merger control was the initial focus in China, the past 2-3 years have seen a rapid increase in investigations for anti-competitive behaviour by the relevant authorities, as well as private actions being brought before the Courts. Although the staffing of the PRC competition agencies remains limited, the increase in the number of investigations recently reflects a more proactive attitude toward enforcement.

In addition to merger review, transactions in certain sectors might be subject to a separate national security review process for the acquisition of domestic PRC companies by foreign investors (pursuant to Article 31 AML) (see section 8).

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\(^1\) Hong Kong has now passed cross-sector competition law, as considered in the Annex to this publication. There are currently no plans for Macau to adopt competition legislation.

\(^2\) In addition, the AML also prohibits the abuse of administrative powers to restrict competition.
2. Enforcement Structure

The AML introduced two new regulatory agencies:

- the Anti-Monopoly Committee under the State Council, which is responsible for developing competition policy, conducting market investigations, publishing guidelines and coordinating the competition administrative enforcement work;\(^3\) and

- the Anti-Monopoly Enforcement Authority designated by the State Council ("AMEA"), which is responsible for the enforcement of the AML.\(^4\)

As shown in Figure 1 below, the enforcement powers of the AMEA are divided between three different agencies.

**Figure 1: The Enforcement Agencies of the AML**

Each of the three different agencies at the central state level has corresponding local bodies that operate at or below provincial level nationwide.

The AML and implementing rules are silent on which agency would have jurisdiction where there is a combination of price and non-price related elements within a single case, although in practice the allocation of the various powers has not proved to be a problem to date.

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\(^3\) AML, Article 9.

\(^4\) AML, Article 10.
3. Implementing Rules

The vast majority of the secondary legislation to date has been in relation to merger control, including guidance and rules on the documents required for merger notifications, conduct of merger reviews, market definition, the filing and review of merger notifications, divestiture remedies and substantive assessment. Recently, MOFCOM has provided some clarification on certain key issues, such as the circumstances that constitute the acquisition of “control” and the treatment of joint ventures under the AML. Whilst some uncertainties remain, MOFCOM has developed its own practice over the past six years. Notably, when compared with the EU, there is no distinction (comparable to the EU Merger Regulation) between full function and non-full function joint ventures and MOFCOM takes a somewhat broader approach than the European Commission on the definition of "joint control" (as demonstrated by MOFCOM’s prohibition decision of the P3 alliance in June 2014).

Because of the allocation of enforcement powers between the NDRC and SAIC (for price related and non-price related matters respectively), there is considerable overlap between these rules, but they are not entirely consistent. For example, leniency was covered in both sets of rules. The NDRC specified that the first undertaking to report proactively a monopoly agreement and provide significant evidence to the relevant authority may obtain a 100% reduction from the fine; the second undertaking to do so may receive a reduction of not less than 50%; and subsequent undertakings may receive a reduction of not more than 50%. The SAIC, however, did not specify the extent of the reduction for undertakings other than full immunity for the first in line (see section 4 below).
4. Anti-Competitive ("Monopoly") Agreements

Anti-competitive agreements are referred to in the AML as "monopoly agreements". The basic principles in this area are comparable to Article 101 of the Treaty on the Functioning of the European Union ("TFEU").

Prohibition
Monopoly agreements are defined in Article 13 AML as agreements, decisions or other concerted behaviour that eliminate or restrict competition. Articles 13 and 14 provide a list of monopoly agreements between competing undertakings that are automatically presumed to be illegal, such as price-fixing agreements or arrangements limiting production or sales volumes, dividing sales or procurement markets, restricting the purchase of new technology or new products or involving resale price maintenance.

Exemption
As with the EU and US regimes, exemption from the prohibition is available. Article 15 AML allows undertakings to rebut the anti-competitive presumption. In order to benefit from the exemption, the undertakings must show all of the following:

- the agreement(s) in fact had a qualifying purpose, such as to upgrade technology or research and development, improve product quality, reduce cost, improve efficiency, enhance the competitiveness of small and medium-sized enterprises, maintain public welfare, or be for the purposes of international trade and foreign economic cooperation;

- the agreement(s) will not substantially restrict competition in the relevant market; and

- consumers will receive a fair share of the resulting benefits.

Enforcement Action
Previously, most of the enforcement action was carried out at the local level. The SAIC and NDRC have delegated their enforcement powers to their local departments (the "local AIC" and the "local price authority" respectively) to carry out investigations of anti-competitive conduct. These investigations are often concluded with the relevant undertaking offering to take corrective measures (without the imposition of a fine), and may not even be reported by the press.

However, recently, we have seen a number of high profile investigations on a national level, focusing on cartels and resale price maintenance. The table below summarises some of the key cases to date.
<table>
<thead>
<tr>
<th>Case description</th>
<th>Fines imposed</th>
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<tbody>
<tr>
<td>LCD panel case involving a price cartel among six foreign LCD panel manufacturers in January 2013</td>
<td>Fines totalling RMB 353 million and a number of behavioural commitments were imposed, with Samsung and LG receiving the highest fines of RMB 101 million and RMB 118 million, respectively</td>
</tr>
<tr>
<td>Liquor case involving resale price maintenance by Kweichow Moutai Co., Ltd and Wuliangye Group, two state-owned producers of premium liquor in February 2013</td>
<td>Fines of RMB 247 million and RMB 202 million were imposed on each party, respectively, for a combined RMB 449 million</td>
</tr>
<tr>
<td>Infant milk powder case involving resale price maintenance by nine international infant formula manufacturers in August 2013</td>
<td>Fines totalling RMB 668.73 million were imposed on six companies by the NDRC; three companies were granted immunity from having to pay fines – see more on leniency below</td>
</tr>
<tr>
<td>Shanghai gold cartel case involving price manipulation by five Shanghai-based gold and jewellery retailers and a local trade association in August 2013</td>
<td>Combined fines of RMB 10.09 million were imposed on the retailers, representing one percent of their 2012 revenues, and a fine of RMB 500,000 was imposed on the trade association for its leading role in creating the pricing scheme</td>
</tr>
<tr>
<td>Irregular, excessive charges or charges without providing service involving 64 bank branches across China in February 2014</td>
<td>Fines totalling RMB 825 million were imposed on 64 bank branches by the NDRC</td>
</tr>
<tr>
<td>Price-fixing for car parts and bearings involving 12 Japanese car parts companies and bearing suppliers in August 2014</td>
<td>Fines totalling RMB 1.24 billion were imposed on the companies by the NDRC</td>
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</table>
Leniency
As indicated above, leniency is available under the AML. Since September 2014, when the NDRC started to publish its penalty decisions, more clarity on its calculation of fines and use of leniency in cartel cases is now available. The published cases show that the NDRC tends to grant full immunity from fines to the first undertaking that self-reports, and impose fines of a varying extent (from 4-8%) according to the order of self-reporting.

We understand that leniency was applied in the LCD panel case. Reportedly, AU Optronics was exempted from administrative fines (which, for the other LCD makers, ranged from 50% to 200% of their illegal gains) because it was the first participant to confess to the NDRC. Note, however, that this case was decided under the Price Law, and not the AML (as the illegal behaviour occurred in 2001 to 2006, prior to the AML coming into effect in 2008). Unlike the AML, the Price Law does not contain specific provisions on leniency but allows the NDRC discretion to take into account confessions and cooperative behaviour in deciding the administrative fine payable.

More recently, leniency was applied in the Japanese car parts/bearings case. According to the published decisions, Hitachi and Nachi were fully exempted from penalties for being the first in line to confess to the NDRC and providing important evidence. Denso and NSK, being second in line, were fined 4% of their respective 2013 revenues in China. Yazaki, Furukawa, Sumitomo and NTN were fined 6% of their 2013 revenues in China, taking into account mitigating circumstances. Aisan Industry, Mitsubishi Electric and Mitsuba were fined 8% of their 2013 revenues in China for reaching price-fixing agreements on more than two products. JTEKT was also fined 8% for suggesting price-fixing meetings specifically targeting the Chinese market. Fines of 8% revenue mark the highest level of penalty imposed by the NDRC so far.

This case sheds more light on the NDRC’s investigation methods, use of leniency procedure and calculation of fines. Mitigating circumstances which the NDRC has taken into account include confession, cooperation and voluntary termination of anti-competitive conduct. The penalties in the cases to date are calculated based on the sales of the actual products within the Chinese market, although the NDRC has left open the option of taking the worldwide sales as the starting point where appropriate in the market in question.
5. Abuse of a Dominant Position

The basic AML principles on the abuse of dominance are comparable to Article 102 TFEU.

Dominant Position Defined
A dominant market position in the AML is defined in Article 17 AML and clarified to some extent by the implementing rules. It refers to a market position held by one or more undertaking(s) that enables it (them) to:

- control the price, volume or other trading terms in the relevant market. "Other trading terms" refers to factors which can have a material impact on market purchases, including product grade, payment terms, method of delivery, after-sales service, trading options, technical constraints etc.; or

- block or affect the ability of another undertaking to enter the relevant market, for example, by delaying another undertaking’s entry into the market or increasing its entry cost so that it cannot compete effectively.

The dominance assessment will depend on a number of factors, including the relevant undertaking’s market shares and the competitiveness of the relevant market, the ability of the undertaking to control the sales or input market, the financial strength and technical resources of the undertaking, the extent to which other undertakings rely on the relevant undertaking and the ease of market entry.5

Market Share Presumption
Unlike Article 102 TFEU, the text of the AML specifies in Article 19 certain market share thresholds which give rise to a presumption of dominance, as set out in Table 1 below.

Table 1: Market Share Thresholds in Article 19 AML for the Presumption of Dominance

<table>
<thead>
<tr>
<th>Number of undertakings</th>
<th>Combined share of the relevant market to create a presumption of dominance</th>
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<tbody>
<tr>
<td>1</td>
<td>Half</td>
</tr>
<tr>
<td>2</td>
<td>Two-thirds</td>
</tr>
<tr>
<td>3</td>
<td>Three-quarters</td>
</tr>
</tbody>
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Presumptions of a dominant position can be rebutted by evidence to the contrary.6 Furthermore, an exception is available where the presumption of dominance is created on the basis of the combined market share of two or more undertakings: if any such undertaking has a market share of less than 10%, it will not be presumed to have a dominant position.

5 SAIC Rules on Abuse of Dominance, Article 10; NDRC Rules on Anti-Price Monopoly Conduct, Article 18.
6 AML, Article 19.
The decision by the Supreme People’s Court (“SPC”) in Qihoo 360 Technology Co., Ltd v Tencent Inc. demonstrates that it is possible to rebut the above presumption. Tencent was held not to have a dominant position despite having a market share exceeding 80% in the instant messaging (“IM”) service market. In reaching this conclusion, the SPC considered factors such as the rapidly developing and constantly changing competitive landscape of the IM service market in China, Tencent’s inability to control price, quantity or other trading terms in that market, the existence of credible competitors who can affect Tencent’s leading position, and evidence of low barriers to entry. The SPC was therefore willing to look beyond the high market share of Tencent and rebut the presumption based on evidence of the market power of Tencent and the dynamics of the IM service market.

Strict reliance on market shares in creating a presumption of collective dominance is unusual. For example, US antitrust laws do not recognise the concept of collective dominance at all. As regards the position in the EU, complex evidence is required to prove collective dominance under Article 102 TFEU, including evidence that the undertakings are linked economically (such as through contractual agreements or structural market factors). There is, however, no mention of such or similar requirements in either the AML or the relevant implementing rules. The authorities may find it impractical to adhere too strictly to these market share tests for collective dominance.

Abuse

Article 17 AML and the implementing rules set out a non-exhaustive list of the types of behaviour that, without justification, would be considered abusive and therefore prohibited. These can be split broadly into:

- **Exploitative abuses**: the dominant company abuses its position by exploiting its customers or suppliers, for example, by selling at unfairly high prices or buying at unfairly low prices; and

- **Exclusionary abuses**: the dominant company abuses its position by excluding its competitors, for example by selling below cost, refusing to trade (including, without objective reasons, reducing existing transaction volumes, delaying or suspending an existing transaction, imposing prohibitively restrictive conditions, denying access to essential facilities), requiring exclusivity, implementing tie-in sales or imposing other discriminatory or unreasonable trading terms.

Noteworthy cases

- **Qualcomm**: In November 2013, the NDRC launched an investigation into the alleged abuse of a dominant position by Qualcomm, a technology company, for charging Chinese companies excessive royalty fees, as well as for other practices such as bundling and requiring licensees to cross-license their patents for free. The investigation remains ongoing.

- **Microsoft**: In July 2014, the SAIC conducted dawn raids at Microsoft offices in China as part of an investigation on abuse of its dominant position through imposing compatibility restrictions on its Windows operating system and software and tying arrangements. The investigation is currently ongoing.

- **Tetra Pak**: In July 2013, the SAIC announced its investigation into the alleged abuse of a dominant position by Tetra Pak, the Swedish provider of food and beverage packing equipment and related services. It is alleged that
Tetra Pak tied the sale of its packaging materials to its equipment and engaged in discriminatory treatment favouring certain customers. The investigation is currently still ongoing.

- **Shuntong / Huaxin**: In November 2011, two pharmaceutical companies, Shandong Weifang Shuntong Pharmaceutical Co. Ltd. (“Shuntong”) and Weifang Huaxin Medicine Trading Co. Ltd. (“Huaxin”), were fined a total of around RMB 7 million by the NDRC for unlawfully controlling the supply of promethazine hydrochloride in China by entering into exclusive sales agreements with the only two manufacturers of the ingredient and subsequently driving up prices.⁷

- **Unicom / Telecom**: On 9 November 2011, the NDRC initiated an investigation into China Unicom and Telecom over alleged monopolistic price discrimination in the market for broadband Internet service. This was the first time in which a regulator has targeted large state owned enterprises in relation to antitrust enforcement in China. By undertaking to lower the price, Unicom and Telecom applied for adjournment of the investigation on 2 December 2011, and both submitted improvement reports to the NDRC in February 2012. So far no fine has been imposed, but the NDRC has been urging Unicom and Telecom to carry out rectification of their monopolistic behaviour which could take up to three to five years to complete.

- **Unilever**: In May 2011, Unilever was fined RMB 2 million by the NDRC for comments about possible price rises. The NDRC imposed the fine under the Price Law, but suggested that it also involved a potential price-fixing cartel as several major personal care producers indicated their intentions to increase price following Unilever’s warning.

**Intellectual Property Rights**

The interplay between competition law and protection of intellectual property rights has, in recent years, been a focus of enforcement activity in many jurisdictions globally, including in China. Remarkably, given that the AML has only been in force for six years, both the regulators and courts have demonstrated a willingness to engage with difficult issues regarding intellectual property rights in complex and high profile cases such as *Huawei v InterDigital* and the NDRC’s investigations into the licensing practices of patent holders such as InterDigital and Qualcomm.

In *Huawei v InterDigital* the Shenzhen Intermediate People’s Court found that InterDigital had:

(i) abused its dominant position by: (a) making proposals for excessive royalties; (b) tying its SEPs with non-SEPs during licensing negotiations; (c) insisting on Huawei’s cross-licensing of all its own patents on a royalty-free basis; and (d) seeking injunctive relief before the US District Court for the District of Delaware and before the US International Trade Commission whilst still in negotiations with Huawei to force it to accept unreasonable licensing terms, including excessive royalties; and

(ii) failed to comply with FRAND commitments by commencing injunction proceedings and asking Huawei to pay higher royalties than those paid by Apple and Samsung (the court found that InterDigital required Huawei to

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⁸ [http://www.ndrc.gov.cn/xwfb/t20111114_444330.htm](http://www.ndrc.gov.cn/xwfb/t20111114_444330.htm)
pay significantly higher royalty rates than Apple, Samsung and other companies – sometimes 100 times higher) even though Huawei had smaller global sales.

The Shenzhen Court became the first court to determine a fair, reasonable and non-discriminatory royalty rate. The Shenzhen Court’s decision was subsequently affirmed on appeal by a higher court although a petition for leave to appeal has since been submitted to the SPC with respect to the calculation of the royalty rate. If allowed, an SPC decision on this issue could provide clarity on the approach to be followed by Chinese courts when determining a FRAND royalty rate.

Separately, NDRC has been investigating both Qualcomm and InterDigital for charging Chinese companies excessive royalty fees, as well as for other practices such as bundling and requiring licensees to cross-license their patents for free. InterDigital has since agreed to abide by certain commitments, although the investigation into Qualcomm remains ongoing. More recently, the SAIC has also reportedly commenced an abuse of dominance investigation into Microsoft for abuse of dominance regarding interoperability and other competition concerns related to the Windows operating system and Office software.

Chinese courts and regulators have also been pro-active in developing guidance on the assessment of intellectual property rights under the AML. The SAIC for its part has been engaged in a lengthy process of developing and consulting on guidelines regarding its approach to intellectual property rights in antitrust enforcement. After more than five years of preparation and many rounds of consultation, the Regulation on the Prohibition of Abuse of Intellectual Property Rights to Eliminate or Restrict Competition (the “IP Regulation”) is expected to be published imminently. The IP Regulation addresses intellectual property-related abusive conduct and (to a lesser extent) anticompetitive agreements, and covers specific issues such as exclusive dealing, tying, imposition of unreasonable conditions, differential treatment, patent pools, and standard setting. The provision which has given rise to the most concerns among companies (both Chinese and Western) and foreign competition agencies (including the US Department of Justice) is the introduction of the essential facilities doctrine into an analysis of the exercise of intellectual property rights under the AML. In particular, the IP Regulation provides that a dominant undertaking is prohibited from refusing, without justification, to license its intellectual property rights on reasonable terms where such rights constitute essential facilities for manufacturing and operating activities. The SAIC has taken on board some of the concerns raised during the public consultation. As a result, the IP Regulation sets out a number of conditions which must be satisfied for the intellectual property rights to be considered as essential facilities. Nonetheless, the adoption of such a doctrine, and the scope for the SAIC to adopt a wide approach in interpreting such criteria, results in considerable uncertainty for intellectual property holders.

The SPC is also currently consulting on two draft judicial opinions on the trial of patent cases. The SPC’s Draft Interpretation (II) on Certain Issues Concerning the Application of Law in the Trial of Patent Infringement Cases notably proposes that licensing terms and conditions of standard-essential patents (SEPs) be determined under the fair, reasonable and non-discriminatory (FRAND) principles, and that infringement claims from patentees who violate FRAND principles upon failing to negotiate in good faith with licensees will generally be rejected by the court. The SPC’s Draft Decision on Revising Application of the Law in the Hearing of Patent Dispute Cases proposes that royalties damages be calculated by reference to the losses to patent owners or the illegal gains to patent violators and, where such losses or gains are difficult to quantify, prior patent licensing fees, unless it would be manifestly unreasonable to do so. These draft opinions are expected to be finalised in due course.
6. Merger Control

From an enforcement perspective, merger control is currently by far the most advanced of the three types of monopolistic conduct, not least because merger filings were required under a different set of rules (the M&A Rules) in the PRC before the implementation of the AML. The M&A Rules were subsequently revised in June 2009 to bring them in line with the AML jurisdictional thresholds.

Jurisdictional Thresholds
The turnover thresholds are as follows (see Figure 2 for flowchart):

- either the combined global turnover of all the undertakings concerned (e.g. the purchaser group and the target) exceeds RMB10 billion (c. €1.2 billion) or the combined turnover within the PRC of all the undertakings concerned exceeds RMB2 billion (c. €240 million), in the preceding financial year; and

- the turnover within the PRC of each of at least two of the undertakings concerned in the preceding financial year exceeds RMB400 million (c. €50 million).

As in the EU and US, there are special turnover threshold rules in the PRC for financial institutions, such as banks and insurance companies, which are already regulated by other agencies (e.g. the China Banking Regulatory Commission). The AML rules state that once all the various income items belonging to the financial institution have been aggregated, only 10% of the aggregate will be taken into account for the purposes of the turnover thresholds.

In addition, MOFCOM has the right to investigate a merger not exceeding the turnover thresholds where “facts and evidence collected in accordance with prescribed procedures establish that such concentration effects, or is likely to effect, the elimination or restriction of competition”. It remains unclear under what circumstances MOFCOM will exercise this power, but some guidelines have been provided in MOFCOM’s Interim Provisions on Assessment of the Impact of Concentration of Undertakings on Competition. There have been no such reported cases to date and MOFCOM is likely to do so only in cases where serious competition concerns are expected or in high-profile product markets.

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9 Provisions of the State Council on Thresholds for Prior Notification of Concentrations of Undertakings (Decree of the State Council of the PRC No. 529), Article 4 (taken from official English translation on MOFCOM’s website).
Notification of Concentration of Undertakings

In June 2014, MOFCOM revised the Guideline for Notification of Concentration of Undertakings ("Guideline") to clarify what types of transaction require merger control clearance. The Guideline for the first time explains what constitutes control, and clarifies the situation for joint ventures and calculation of revenues.

According to Article 1 of the Guideline, "concentration of undertakings" means the circumstances stipulated in Article 20 AML, including merger of undertakings, acquisition of control over other undertakings by acquiring their equity or assets and gaining control or decisive influence over other undertakings by contracts or other means. Control can be acquired either by the undertakings themselves directly or by their controlled undertakings indirectly. Article 3 of the Guideline states that control of a concentration includes sole control and joint control. It also notes that transaction documents and constitutional documents (e.g. bylaws) are relevant evidence in assessing whether a deal requires a filing.

The Guideline does not adopt any percentage threshold for establishing control. It recognises the possibility of acquiring de facto control through acquisition of a small stake due to reasons such as fragmented ownership.

The Guideline also lists seven non-exhaustive factors that MOFCOM will take into consideration when deciding whether a transaction entails the acquisition of control. These include:

Figure 2: Turnover thresholds in the AML

Does the combined global turnover of all the undertakings concerned (e.g. the purchaser group and the target) in the preceding financial year exceed RMB10 billion (c. €1.2 billion)?

Does the combined turnover within the PRC of all undertakings concerned in the preceding financial year exceed RMB2 billion (c. €240 million)?

Does the turnover within the PRC of each of at least two of the undertakings concerned in the preceding financial year exceed RMB400 million (c. €50 million)?

Yes

No

The turnover thresholds are met

The turnover thresholds are not met
• the objectives of the transaction and relevant future plans;
• the change in the shareholding structure;
• the voting agenda and mechanism of shareholders’ meetings, past attendance rate and resolutions;
• the structure and voting mechanism of the board of directors and board of supervisors;
• the appointment and dismissal of senior executives;
• the relationship between shareholders and directors, and whether there are votes by proxy or persons acting in concert in place; and
• whether there is a significant commercial relationship or a cooperation agreement between the undertakings.

The Guideline makes it clear that the merger notification obligation applies to joint ventures. According to Article 4, newly established joint ventures should only be notified when two or more undertakings acquire joint control. If only one undertaking controls the joint venture, this will not be considered as a concentration of undertakings.

It is important to bear in mind that, unlike the EU, MOFCOM does not distinguish between full-function and non-full function joint ventures. Close-knit alliances may also attract regulatory scrutiny under merger control in the PRC. A recent example is that the proposed P3 alliance between Maersk Line, Mediterranean Shipping Co and CMA CGM was a relevant concentration and notifiable to MOFCOM whereas it was not notifiable under the EU merger control regime.

The Guideline further clarifies the calculation of turnover. Under Article 5 of the Guideline the turnover “within China” refers to the turnover generated from sales to customers located within China and therefore includes overseas imports into China, but not exports from China.

**Merger Notification Process**

According to Article 25 AML, the initial merger review period (“Phase I”) is 30 days. In practice, this period does not start as soon as the parties submit the notification to MOFCOM; it starts only after MOFCOM accepts the notification as complete. During the period between submission and acceptance (often referred to as the “pre-acceptance period”), MOFCOM is almost certain to request supplementary documents and information. This delay can be reduced to some extent by preparing as complete a notification as possible from the outset and by responding to MOFCOM’s (often very lengthy) information requests as quickly as possible, but it can be difficult to predict with any certainty when the review period will start. Notifying parties should generally allow at least 2-4 months for this process as the pre-acceptance period (although this varies according to MOFCOM’s workload).

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10 The AML and the implementing rules are silent as to whether this refers to calendar or working days, but MOFCOM’s practice is to use calendar days.
After the initial review period, MOFCOM can extend its review by a further 90 days if a more detailed investigation is required (commonly referred to as “Phase II”), which in turn can be further extended by up to 60 days if the merging parties agree (“Phase III”). Unlike the EU, there is no substantive threshold for MOFCOM to commence a Phase II review; it may do so simply because it does not have sufficient time to complete its review in the initial 30 days. In cases where MOFCOM requires additional time beyond Phase III, the notifying parties may choose to withdraw and re-file the notification to restart the timetable (Western Digital/Hitachi, Glencore/Xstrata, Marubeni/Gavilon, MediaTek/Mstar and AMAT/Tokyo Electron).

The Simplified Procedure
On 11 February 2014, MOFCOM announced its long-awaited fast-track simplified procedure for “simple cases” that do not raise competition concerns in China. The aim of the new procedure is to speed up the merger review process which could see “60% of notified transactions” cleared within Phase I. The simplified procedure has two key advantages: it significantly shortens the time taken to obtain merger approvals and reduces the administrative burden on notifying parties for simple cases.

The simplified procedure is available for the following types of transactions:

- off-shore joint ventures with no activities in China;
- changes from joint to sole control of a joint venture (except where the sole parent and the joint venture compete in the same market); or
- transaction where the parties have a combined market share of less than 15% if they compete in the same market; and each have market share of less than 25% if they are active in any vertically related or neighbouring markets.

In our experience, the simplified procedure is a positive development and has encouraging results. MOFCOM now aims to grant clearance within Phase I. The first case to take advantage of the simplified procedure was Rolls-Royce Holdings plc’s acquisition of Daimler’s 50% shareholding in their 50:50 joint venture, Rolls-Royce Power Systems (which we acted on). It was cleared by MOFCOM only 19 days after formal acceptance.

For simple cases, MOFCOM publishes a notice on its website for consultation with third parties for ten calendar days. Whilst the simplified procedure facilitates speedy review, it also increases transparency and may attract complaints more easily. As of 26 January 2015, 95 simple cases have been published so far.

Since the implementation of the AML, as of 31 December 2014, 961 cases were unconditionally approved. These have been made public since 15 November 2012 pursuant to the Regulation on the Disclosure of Government
Information. As of 31 December 2014, MOFCOM has prohibited two transactions: Coca-Cola’s proposed acquisition of Chinese juice producer Huiyuan (prohibited in March 2009); and the proposed establishment of the P3 alliance by A.P. Møller – Maersk A/S, MSC Mediterranean Shipping Company S.A. and CMA CGM S.A. (prohibited in June 2014). 27 clearance decisions have been made subject to conditions (often involving a mixture of behavioural and structural remedies).

Substantive Assessment
In assessing mergers, MOFCOM considers whether the merger will or may eliminate or restrict market competition. Even if this test appears to be met, it remains open to the parties to prove that the advantages of the merger outweigh the disadvantages or that it is in line with the public interest.\(^\text{14}\)

In August 2011 MOFCOM published its “Provisional Rules on the Assessment of Competitive Effects of a Concentration” which sets out the factors that MOFCOM will consider when making its substantive assessment. This includes concepts that are familiar to the EU and other competition regimes (market shares, degree of concentration by reference to the Herfindahl-Hirschman Index and the Concentration Ratio, barriers to entry, technological barriers, production capacity in the market etc.). In addition, it identifies certain possible defences, including public interest, economic efficiency, undertakings on the verge of bankruptcy and countervailing buyer power. However, MOFCOM has not adopted the same terminology in respect of the theories of harm – for example, the rules do not refer to “coordinated” or “unilateral” effects – thereby enabling MOFCOM to retain a greater degree of flexibility when assessing transactions.

Overview of Conditional Clearance and Prohibition Decisions To Date
MOFCOM has imposed both structural and behavioural conditions on merging parties. In appropriate cases, companies are able to propose behavioural remedies to address MOFCOM’s competition concerns as an alternative to structural remedies that tend to be preferred by the EU and US antitrust agencies. It is also worth noting that, as in other jurisdictions, customer or third party concerns can play a significant role in MOFCOM’s assessment of a proposed merger.

Recent cases have highlighted the fact that the outcome of MOFCOM investigations can sometimes be unpredictable and uncertain, even where market shares may appear to be relatively low. In some international mergers, MOFCOM has intervened by imposing conditions even where a transaction has already received unconditional clearances in other jurisdictions, or by going beyond the conditions that have been imposed in other jurisdictions.\(^\text{15}\) This can be the case even where the market shares might not, prima facie, appear to raise competition concerns. For example, the markets in which MOFCOM expressed concerns in Glencore/Xstrata involved market shares of less than 18%; similarly, in Marubeni/Gavilon, MOFCOM had concerns about Marubeni’s 18% share of the imported soybean market in China. MOFCOM has also prohibited transactions which were cleared or not prohibited elsewhere. For example, the proposed P3 alliance was prohibited by MOFCOM on 17 June 2014 for the impact on the Asian Europe routes whereas the US Federal Maritime Commission cleared the transaction on 20 March 2014 and the EU Commission decided not to initiate proceedings.

\(^{14}\) AML, Article 28.

\(^{15}\) For example, see Western Digital/Hitachi, Google/Motorola Mobility, Glencore/Xstrata, Marubeni/Gavilon, and Baxter International Inc./Gambro AB.
Merger Remedies

On 4 December 2014, MOFCOM published the regulations on remedies in merger review entitled “Interim Regulations on Imposing Restrictive Conditions on Concentrations of Undertakings” (the “Remedies Regulations”). According to MOFCOM, the Remedies Regulations aim at improving the enforcement and monitoring of merger conditions as well as reducing any negative impact on competition brought by concentrations.

The Remedies Regulations set out the process for negotiation and determination of remedies. MOFCOM requires remedy proposals to be submitted within 20 days before the end of Phase II (Article 6). The Remedies Regulations also contain a “crown jewel” provision under which MOFCOM may require the undertakings concerned to provide an alternative proposal that contains stricter conditions and may include core tangible and intangible assets (Article 7). MOFCOM may market test the remedy proposals by way of (i) questionnaire; (ii) hearings; (iii) consultation with experts; or (iv) other means (Article 8).

The Remedies Regulations prescribe detailed requirements for implementation of remedies, including the criteria for choosing a suitable purchaser, a monitoring trustee and a divestiture trustee, the duties of the undertakings subject to the divestment commitments, and the duties of a monitoring trustee and a divestiture trustee. MOFCOM may require an upfront buyer where (i) the viability and marketability of the business to be divested is at risk; (ii) the identity of the purchaser of the divestment business is critical to the effectiveness of the remedies in restoring competition; or (iii) third parties assert rights over the divestment business (Article 14).
Private claims for damages resulting from anti-competitive conduct is a growing area in the PRC, not least because customers have been quick to rely on Article 50 AML, which entitles individuals and companies to bring private actions against undertakings that have engaged in monopolistic conduct. The Courts have been remarkably willing to hear such cases, despite the lack of implementing rules or any historic expertise or experience in conducting the necessary competitive assessment.

The first Court decision on an Article 50 private damages claim was handed down on 23 October 2009. The Shanghai No.1 Intermediate People's Court rejected the claim on the basis that the claimant, Beijing Sursen Electronic Co Ltd (“Sursen”), had failed to produce sufficient evidence that the defendants, Shanda Interactive Entertainment and Shanghai Xuanting Entertainment Information Technology, were dominant. Sursen alleged that the defendants had abused their dominant positions by pressurising two authors not to write a sequel to a novel series that was originally published by the defendants. The value of the claim was RMB 9,800 (c. €1,170). In addition, the Court held that the defendants were justified in their actions as they are entitled to enforce their intellectual property rights. This decision was upheld by the Shanghai Higher People’s Court.

Since then, there have been a number of high profile cases, including:

- **Qihoo v. Tencent**, which was the first competition case to be heard by the Supreme People's Court and involved complex issues of market definition and expert evidence from international competition economists;

- **Rainbow Medical Equipment & Supply Company v. Johnson & Johnson**, which was the first time the Court decided on issues of resale price maintenance. The Shanghai Courts appeared to adopt a 'rule of reason' approach to the question of resale price maintenance; and

- **Huawei v. InterDigital**, which involved intellectual property issues regarding essential patents. The Shenzhen Intermediate People's Court (affirmed by the Guangdong Higher People's Court) determined the level of royalties payable for use of InterDigital’s essential patents.

In a step which has been applauded for introducing greater transparency in the country's legal system, the Supreme People’s Court began publishing rulings online in July 2013. However, the degree of disclosure remains uneven; decisions are published intermittently in batches, and cases involving national security, commercial secrets and individual privacy will not be posted.
8. National Security Review

Pursuant to Article 31 AML, a separate national security review, with a separate review process and timetable, might be necessary if a transaction involves the acquisition of a domestic PRC company by a foreign investor in certain sectors. This includes military industrial enterprises and enterprises located near key and sensitive military facilities, national defence enterprises, enterprises with a bearing on national security in areas including important agricultural products, energy and resources, infrastructure facilities, transportation services, key technologies and manufacturing of major equipment. Provisional rules were issued in March 2011, which were superseded by a new set of rules issued in August 2011.

National security reviews fall within MOFCOM’s jurisdiction. Local commerce departments are responsible for screening – during the foreign investment approval process – whether the relevant transaction requires a national security review. In addition, third parties such as other governmental agencies, industry associations and enterprises in the same or upstream/downstream industries can also trigger this process by proposing to MOFCOM that a review be conducted. Alternatively, parties may make a voluntary filing to MOFCOM for a national security review.

MOFCOM has an initial 15 working days to determine if the transaction falls within the scope of a national security review. If so, the case is passed onto the ministerial joint committee, which then has up to 90 working days (30 working days for a "general" review period, followed by a further 60 working days of a "special" review period) to issue a decision. If a case requires both a national security review and a merger review, MOFCOM is likely in practice to postpone acceptance of the merger notification until the joint committee has issued its decision on the national security aspects of the transaction.
Annex: Hong Kong

INTRODUCTION
Until recently, only the telecommunications and broadcasting sectors were subject to competition law in Hong Kong. Since 2006, there have been calls for Hong Kong to introduce a cross-sector competition law, which would establish statutory powers for a competition authority to investigate suspected infringements and to impose sanctions.

On 14 June 2012, the Competition Ordinance was passed by the Hong Kong Legislative Council, after much debate and input on the bill from various stakeholders over a two-year period. This extends the application of competition law to all sectors in Hong Kong, whereas merger control will continue to apply only to the telecoms sector.

The Competition Ordinance is expected to come into full operation in the second half of 2015. Prior to this, businesses will have to assess their current practices in light of the law and make any necessary changes.

Certain provisions of the Ordinance relating to the establishment of the Competition Commission and the Competition Tribunal (see further below) have already come into effect. This phased implementation of the Ordinance is intended to allow sufficient time for the preparation of the necessary infrastructure, such as drafting guidelines regarding the competition rules, carrying out consultations, and promoting public understanding of the Ordinance. On 26 April 2013, the Government appointed the chairperson and members of the Competition Commission, whose primary responsibility is to investigate suspected breaches of the Ordinance. Dr. Stanley Wong was appointed the Chief Executive Officer of the Competition Commission with effect from 3 September 2014. He is supported by Ms. Rose Webb as Senior Executive Director. The Competition Tribunal, which is part of the Hong Kong judiciary and will adjudicate cases under the Ordinance, was established on 1 August 2013.

On 26 May 2014, the Competition Commission published a document entitled “Getting Prepared for the Full Implementation of the Competition Ordinance”. After a process of public engagement, on 9 October 2014, the Competition Commission published draft guidelines on, inter alia, the interpretation of both the First Conduct Rule and the Second Conduct Rule (“Draft Guidelines”) for public consultation before being reviewed by the Legislative Council in 2015 and finalised thereafter. The Competition Commission indicated it would issue draft guidelines on enforcement priorities and leniency in due course.

WHAT DOES THE COMPETITION ORDINANCE (THE “ORDINANCE”) COVER?
The Ordinance prohibits the following three types of anti-competitive practices:

- Anti-competitive agreements: agreements, concerted practices or decisions between undertakings with the object or effect of preventing, restricting or distorting competition in Hong Kong (the “First Conduct Rule”);
- Abuse of market power: abuse by undertakings with a "substantial degree of market power" by engaging in conduct with the object or effect of preventing, restricting or distorting competition in Hong Kong (the “Second Conduct Rule”); and
- Telecommunications mergers: with respect to telecommunications licensees, any merger that has, or is likely to have, the effect of substantially lessening competition in Hong Kong (the “Merger Rule”). The current intention
is not to extend the merger regime to other sectors, although the Government has indicated that this position may be reviewed in the next few years.

The Ordinance further defines certain hardcore activities as “serious anti-competitive conduct” in relation to the First Conduct Rule. These consist of: price-fixing, bid-rigging, market allocation and output control. They are considered to be particularly serious offences and will be subject to a stricter enforcement regime as set out below.

FIRST CONDUCT RULE: ANTI-COMPETITIVE AGREEMENTS

What does this catch?
The First Conduct Rule prohibits any agreement (or concerted practice) which has an anti-competitive object or effect in the Hong Kong market. The following are four basic “don’ts” in relation to conduct with competitors:

• Don’t discuss prices, discounts, rebates, supply terms, profit margins or any other terms of business or exchange any commercially sensitive information.

• Don’t agree to limit production, markets, technical development or investment.

• Don’t agree to share markets, territories, customers or sources of supply.

• Don’t engage in bid-rigging (e.g. agreeing on the terms of the bid, agreeing not to submit a bid or agreeing to withdraw a bid).

Are “vertical agreements” caught?
Although the Government has indicated that most vertical agreements (agreements between businesses at different levels of the supply chain) are likely to be exempted on the basis that they are, in general, unlikely to have an anti-competitive effect in Hong Kong, the Competition Commission has not granted any exemption for vertical agreements, but provides in the Draft Guidelines that they may have the object or effect of harming competition. The Draft Guidelines, however, acknowledge that they are unlikely to give rise to competition concerns unless there is market power, and that they are generally less harmful and offer greater scope for efficiencies.

How does the First Conduct Rule apply to trade associations?
It is generally recognised that trade associations can be beneficial in improving standards and ensuring better service to customers. However, they also provide the opportunity for competitors to discuss various issues that fall on the wrong side of the line. Therefore, trade associations must be careful to ensure that any exchange of information is compliant with competition law.

Are there any other exclusions?
The Ordinance contains a de minimis exclusion from the First Conduct Rule for all agreements between undertakings with a combined annual global turnover not exceeding HK$200 million, provided such agreements do not constitute serious anti-competitive conduct. At this stage it is not clear whether this refers to group turnover – or only the turnover of the relevant undertaking.
In addition, there are certain exclusions for agreements which enhance economic efficiency, which are undertaken to comply with legal requirements or undertaken by undertakings entrusted by the Government with the operation of services of general economic interest.

SECOND CONDUCT RULE: ABUSE OF MARKET POWER

What constitutes a “substantial degree of market power”?
An undertaking that has a large proportion of the business in a relevant market is likely to be found to have a “substantial degree of market power”.

Note that this is a lower threshold than the “dominance” test adopted in the EU, China, Singapore and other jurisdictions. The Government was concerned to ensure that the Rule should be capable of applying to the many sectors in Hong Kong that have two or three big players, none of which would be “dominant”.

The Draft Guideline on the Second Conduct Rule does not refer to any indicative threshold, although the Government has previously indicated that an undertaking with a market share of less than 25% is unlikely to have a “substantial degree of market power”.

What conduct would be caught?
The Ordinance confers on businesses with a “substantial degree of market power” a special responsibility not to engage in behaviour that is considered abusive and which has an anti-competitive object or effect on the Hong Kong market. Conduct will be abusive where it is “exclusionary”, i.e. it prevents competitors from competing effectively or drives them out of the market.

Examples of “abuse” could include predatory pricing (i.e. pricing below cost so as to drive a competitor out of the market), loyalty enhancing rebate schemes, exclusive dealing, tying/bundling and a refusal to supply an essential input to an actual or potential competitor.

What about “exploitative” conduct?
Exploitative conduct is conduct which is unfair to customers (typically excessive pricing).

The Ordinance does not distinguish between “exclusionary” and “exploitative” conduct but it is understood that the focus is likely to be solely on the former (which is consistent with the Draft Guideline).

Are there any exclusions?
The Ordinance contains a de minimis exclusion from the Second Conduct Rule for all undertakings with annual global turnover not exceeding HK$40 million. Again, at this stage it is not clear whether this refers to group turnover – or only the turnover of the relevant undertaking.

In addition, as with the First Conduct Rule, there are certain exclusions for conduct undertaken to comply with legal requirements or undertaken by undertakings entrusted by the Government with the operation of services of general economic interest.
WHAT POWERS WILL THE AUTHORITIES HAVE TO INVESTIGATE A POTENTIAL BREACH?
The Ordinance contains provisions for the setting up of the Competition Commission, whose role is to investigate and prosecute suspected offenders before the Competition Tribunal, which will be a division of the High Court.

The Competition Commission is given a full range of powers in the Ordinance to investigate suspected infringements. These powers include the power to require production of documents and information, to require individuals to attend interviews before the Commission and, if armed with a court warrant, to enter and search premises.

Appointments to the Competition Commission were revealed in April 2013, with Anna Wu, a former chairperson of the Consumer Council, appointed as chairperson. Thirteen other members representing sectors such as law, economics, consumer protection, financial services, commerce and industry were also appointed.

Mr Justice Godfrey Lam and Madam Justice Queeny Au-Yeung were appointed as President and Deputy President, respectively, of the Competition Tribunal, each for terms of three years with effect from August 2013. Every judge of the Court of First Instance will, by virtue of his or her appointment as such, be a member of the Competition Tribunal.

WHAT PENALTIES CAN BE IMPOSED ON A BUSINESS THAT HAS GOT IT WRONG?

Warning Notices and Infringement Notices
If the alleged infringement of the First Conduct Rule does not amount to "serious anti-competitive conduct" (discussed above), then the Commission must issue a "warning notice" requesting the relevant undertaking to cease the relevant conduct within a specified period before instituting proceedings in the Competition Tribunal. Only if the undertaking fails to comply with the warning notice, or repeats the anti-competitive conduct after initial rectification, may the Commission bring proceedings against that undertaking.

If the alleged infringement amounts to "serious anti-competitive conduct", no warning notice can be issued. The Commission may instead choose to bring proceedings in the Competition Tribunal straight away, or it may issue an "infringement notice" which would describe the alleged infringing conduct, set out the evidence on which the Commission formed its view and state the terms on which the Commission would be willing to settle the matter without bringing proceedings in the Tribunal.

At any stage of the Commission’s investigation, the relevant undertakings can offer commitments to take certain action or refrain from taking action to address the Commission’s concerns in lieu of further investigation or formal proceedings in the Tribunal.
Sanctions available to the Competition Tribunal
If proceedings are brought in the Competition Tribunal and an infringement of the First or Second Conduct Rule is found, the Ordinance gives the Tribunal the power to apply a full range of remedies, including:

- financial penalties of up to 10% of Hong Kong turnover for a maximum of three years of infringement (again it is not clear whether this extends to group turnover);
- disgorgement orders (i.e. to pay back the illegal profits made from the infringement);
- damages awards to aggrieved parties;
- injunctions; and
- disqualification orders against directors.

Follow-on actions for damages
If the Competition Tribunal finds that an undertaking has infringed the First or Second Conduct Rule, a third party which has suffered loss as a result of the infringement is able to bring a private action for damages against the relevant undertaking before the Competition Tribunal.

The ruling of the Competition Tribunal (or the relevant appeal court) as to liability in respect of proceedings brought by the Commission will be binding in any follow-on action. The claimant would need to prove only causation and quantum.

The limitation period for follow-on actions is three years from the expiry of the appeal period following a Court decision that the Ordinance has been infringed.

The Ordinance does not provide for a standalone right of action (i.e. where the Competition Tribunal or relevant appeal court has not found an infringement).

CONCLUSION

The Competition Ordinance is a significant step towards enhancing competition and consumer welfare in Hong Kong, but it also presents a big challenge for the business community. Businesses will now have to embark on a journey of understanding and implementing competition law principles, which may in some cases require fundamental changes to the way business is done in Hong Kong.
Natalie was educated at Cambridge University and is resident in Hong Kong. She joined Slaughter and May in 2005 and became a partner in 2014. She has worked in our London, Hong Kong and Beijing offices.

Natalie’s experience covers a range of competition work involving sectoral regulation, antitrust investigations and merger filings. Her antitrust experience involves a number of high-profile cartel investigations, including advising British Airways in relation to the OFT’s criminal and civil investigations into alleged cartel activity involving passenger fuel surcharges on long-haul flights. She also advised Asda Wal-Mart on the OFT’s investigation into dairy products.

Since moving from our London office to Hong Kong in 2009 to develop the firm’s Asian competition practice, Natalie has been responsible for coordinating the PRC and Asian merger notifications on a number of global transactions.

Her recent advice on cross-border transactions in Asia includes:

- Rolls-Royce on its acquisition of the 50% remaining stake in Rolls-Royce Power Systems joint venture from Daimler
- Thermo Fisher Scientific on its proposed takeover of Life Technologies Corporation
- Aegis plc on the recommended cash offer by Dentsu Inc.
- Bertelsmann on its combination with Pearson of their respective trade-book publishing businesses
- INEOS on the creation of a 50/50 oil refining joint venture with PetroChina, the formation of Styrolution with BASF and the proposed joint venture with Solvay in relation to their PVC business
- Prudential plc on its proposed acquisition of AIA Group Limited

In preparation for the Competition Ordinance in Hong Kong, Natalie has been adviser MTR Corporation and other listed companies, investment banks and industry associations. She has advised on compliance issues and provided training to senior management and employees.
Natalie speaks Chinese and English and travels regularly between the Hong Kong and Beijing offices. She is qualified in both Hong Kong and England and Wales.

Natalie is recognised as a leading lawyer in *The International Who’s Who of Competition Lawyers & Economists 2014*. She is listed in *Chambers Asia 2014* and is the author of the Hong Kong chapter of *Getting the Deal Through’s ‘Cartel Regulation’* publication.
We have established particularly close ties with the competition practices of several other leading law firms around the world, so that we can provide a coordinated high-quality service to clients covering key jurisdictions. These include the following five leading firms from other EU Member States, with whom we have co-located our Brussels office (at the above address in the heart of the European Quarter).