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WHITE PAPER

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China's Antitrust Agency Updates Its Enforcement Rules

China's State Administration for Market Regulation ("SAMR") recently released three new antitrust regulations that consolidate the antimonopoly regulations of its predecessor antimonopoly enforcement agencies, but also introduce important changes. This Jones Day *White Paper* reviews the key reforms, which take effect September 1, 2019, and their implications for companies doing business in China. Although the new regulations largely restate existing law, some new rules provide welcome clarity and transparency to under-developed legal principles. In some cases, the new rules foreshadow more enforcement and signal new areas for SAMR's focus. In other circumstances, the rules expand defenses available to companies faced with a SAMR investigation.

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INTRODUCTION

China's State Administration for Market Regulation ("SAMR") recently released three new antitrust regulations[1] that consolidate the antimonopoly regulations of its predecessor antimonopoly enforcement agencies ("AMEAs"), but also introduce important changes.[2] This Jones Day *White Paper* reviews the key reforms, which take effect September 1, 2019, and their implications for companies doing business in China.[3] Although the new regulations largely restate existing law, some new rules provide welcome clarity and transparency to underdeveloped legal principles. In some cases, the new rules foreshadow more enforcement and signal new areas for SAMR's focus. In other circumstances, the rules expand defenses available to companies faced with a SAMR investigation.

THE APPLICABLE SCOPE OF THE COMMITMENT AND SUSPENSION MECHANISM

Article 45 of the Antimonopoly Law ("AML") allows AMEAs to suspend an antitrust investigation if the parties under investigation agree to cease the allegedly unlawful conduct and take effective remedial measures. Prior AML regulations were silent as to the type of cases that qualified for commitment and suspension. With a few exceptions,[4] most suspended AMEA probes have related to abuse of dominance allegations in which investigated parties committed to cease the allegedly unlawful conduct by agreeing, for example, not to sell at discriminatory prices or require exclusive contracts.

Although such settlements largely have not been controversial in abuse of dominance cases, there is disagreement about whether the same treatment should apply to the regulation of monopoly agreements, which are roughly comparable to the law of U.S. Sherman Act § 1 and Article 101 of the EU Treaty. Article 22 of the new *Monopoly Agreements Regulation* clarifies that the commitment and suspension mechanism applies to all types of AML violations, except for three "hardcore" cartel violations, price fixing, output restrictions, and market allocations. Examples of conduct that now falls within the commitment and suspension mechanism include resale price maintenance, restrictions on application of new technologies or new equipment, exclusive agreements, and most-favored nation clauses, among other conduct. Therefore, companies that find themselves under SAMR investigation for monopoly agreements, other than for hardcore violations, should weigh the benefits of a commitment to end the conduct.

ADJUSTMENTS TO LENIENCY POLICIES

Prior to the unification of China's AMEAs under one agency, as detailed in our June 2018 *White Paper*, the State Administration of Industry and Commerce ("SAIC") and National Development and Reform Commission ("NDRC") had distinct responsibilities. The NDRC dealt with price-related AML violations, whereas the SAIC dealt with non-price-related AML violations. Although the SAIC and NDRC AML implementing regulations featured largely similar leniency programs, there were a number of practical differences that led to confusion. Examples include who could receive leniency, the supply of evidence necessary to obtain leniency, and the amount of any fine reductions, among other issues.[5]

The *Monopoly Agreements Regulation* harmonizes these differences and adopts a unified leniency program framework. According to Article 34 of the *Monopoly Agreements Regulation*, the first applicant for leniency that provides important information may be exempted fully or receive a reduction of 80% or more of potential fines. The second leniency applicant may receive a 30% to 50% fine reduction, and a 20% to 30% reduction is available for the third applicant.

The most significant change is to the treatment of the first leniency applicant. Under the prior SAIC and NDRC regulations, AMEAs typically granted the first leniency applicant a complete exemption when an applicant met the conditions for leniency. The new *Monopoly Agreements Regulation*, however, adopts a more conservative approach, leaving room for SAMR to impose some fine, albeit largely reduced, against the first applicant. Although it is too early to say whether SAMR will deviate from prior practice, it has discretion whether to grant a total exemption or merely reduce fines. A company considering a leniency application should weigh the possibility that it may not receive a complete exemption, even if it is the first to report a violation.

The *Monopoly Agreements Regulation* also does not distinguish non-hardcore cartels from hardcore cartels, or

vertical agreements[6] from horizontal agreements. Therefore, the leniency program covers all types of monopoly agreements, including non-hardcore cartels and resale price maintenance ("RPM"), which is distinct from other major jurisdictions with leniency programs. However, this is not a change in China because the predecessor AMEAs also applied leniency program in non-cartel cases. For example, in the *baby formula RPM* case (2013) and the *contact lenses RPM* case (2014), the NDRC exempted several companies allegedly involved in RPM violations from penalties due to self-reporting and submission of important evidence.[7]

TWO APPROACHES TO MONOPOLY AGREEMENTS

The *Monopoly Agreements Regulation* adopts a divergent analysis for monopoly agreements cataloged in Articles 7 to 12 and those agreements that fall beyond the scope of those articles. Articles 7 to 12 of the *Monopoly Agreements Regulation* prohibit price fixing, output restrictions, market allocations, restrictions on application of new technologies or new equipment, joint boycotts, and RPM. However, Article 13 of the regulation includes a catchall provision that prohibits "any other agreements, decisions or concerted actions that fall beyond the scope of the situations set forth in Article 7 to 12 … when evidence show[s] abovementioned agreements eliminate or restrict competition."

Under the new regulation, SAMR presumes that the monopoly agreements specified in Articles 7 to 12 have anticompetitive effects and therefore condemns such agreements as per se illegal. In contrast, SAMR bears the burden to prove anticompetitive effects of agreements that fall under Article 13 before such agreements are deemed unlawful.

Furthermore, according to Article 13, SAMR must consider multiple factors, as a whole, before it can condemn an agreement as illegal. These include: (i) the relevant companies have actually entered into and implemented the agreement; (ii) the conditions of market competition; (iii) the market shares of the companies concerned and their ability to control the market; (iv) the effects of the agreement on price, quantity, and quality of the products; (v) the effects of the agreement on market entry and technology development; and (vi) the effects of the agreement on consumers and other market participants. This standard is comparable to the rule of reason approach in the United States.

Finally, it is worth noting that the new regulation does not incorporate the proposed market share safe harbors that SAMR included in its draft regulation for public comment.[8] As a result, companies accused of violating Article 13 may not be able to rebut SAMR's allegation of monopoly agreements relying solely on low market shares.

COLLECTIVE DOMINANCE AND CONCERTED PRACTICES

The new regulations also clarify SAMR's rules regarding collective dominance and concerted practices, shedding some light on the agency's attention to parallel behavior, such as parallel pricing, in oligopolistic markets.

Although the AML does not use the term "collective dominance," Article 19 of the AML provides the possibility that two or more companies may be presumed as collectively dominant.[9] However, Article 19 of the AML does not identify the circumstances in which the market shares of two or more companies should be combined to establish this presumption. Article 19 also does not explain how a presumption based on combined market shares accords with the extensive qualitative conditions SAMR must prove to find market dominance under Articles 17 and 18 of the AML.

Article 13 of the new *Abuse of Dominance Regulation* clarifies that "to find two or more undertakings to have a dominant market position, … the market structure, the transparency of the relevant market, the degree of homogeneity of the relevant products, and the uniformity in conduct of the undertakings shall also be considered." In other words, to establish collective dominance, SAMR must consider the factors identified in Article 18 of the AML, which apply to both collective and individual dominance, as well as additional factors in Article 13 of the *Abuse of Dominance Regulation.* These are demanding requirements.

The new regulations also provide SAMR with tools to address concerted practices where no agreement among competitors exists. According to Article 6 of the *Monopoly Agreements Regulation*, SAMR can find concerted practices after taking into account various factors as a whole: (i) the uniformity in conduct of the companies concerned; (ii) the existence of communication or exchange of information between the companies; (iii) whether

there are justifications for the uniform conduct; and (iv) market structure, competitive conditions, and changes in the market.

In theory, both collective dominance and concerted practices are intended to address coordination among competitors even though the competitors under investigation have not reached an agreement. Both theories are controversial in many jurisdictions outside of China, and it is not clear how SAMR will apply this new regulation. At a minimum, companies should expect more attention from AMEAs to parallel behavior, even though such behavior is not necessarily a violation of the AML and the new regulations.

MORE DETAILED RULES FOR CERTAIN ABUSE OF DOMINANCE CONDUCT

The new *Abuse of Dominance Regulation* provides additional guidance regarding certain abusive conduct such as pricing below cost (i.e., predatory pricing). The appropriate measure of cost below which pricing is considered "predatory" has been long debated. Under Article 15 of the *Abuse of Dominance Regulation*, SAMR clarifies for the first time that will use "average variable cost" as the appropriate cost benchmark. Article 15 also indicates that SAMR will consider both relevant free-of-charge and paid products in predatory pricing cases involving internet businesses or other new economy ventures.

The new *Abuse of Dominance Regulation* also modestly updates Article 14, which identifies factors that AMEAs consider to find an unfair pricing violation. Prior NDRC regulations considered comparable prices of other undertakings and an undertaking's own cost and margin. Under the new regulation, SAMR also will consider as a benchmark a dominant undertaking's own prices in other comparable geographies.

NEW DEFENSES FOR CERTAIN ABUSE OF DOMINANCE ALLEGATIONS

The new regulations provide new defenses to justify certain abuse of dominance conduct, which provides more opportunities for companies to defend their conduct in investigations. For example, in tying investigations or investigations of unreasonable transactional terms, justifications include:

- the practice is consistent with industrial norm and transactional traditions;
- the practice is necessary for product safety reasons;
- the products cannot be produced or sold in the absence of the practice; and
- other justifiable reasons.

Of course, whether a company's reasons ultimately justify the conduct is within SAMR's discretion and is determined on a case-by-case basis.

SAMR'S STRENGTHENED ENFORCEMENT SUPERVISION AND GUIDANCE

Apart from the changes of substantive rules, additional procedural rules will facilitate SAMR's supervision its provincial AMEA branches and help SAMR guide their enforcement activities.

Under the new regulations, the provincial AMEAs must report to SAMR within seven business days after initiating an investigation of an alleged AML violation. Provincial AMEAs also have to report to SAMR before suspending, terminating, or imposing penalties in an investigation.

CONCLUSION

In conclusion, although most of the new regulations merely restate prior NDRC and SAIC rules, there are key changes that either clarify the law or foreshadow SAMR's future enforcement priorities. For companies with business in China, the most significant takeaways are:

- A commitment and suspension settlement may be available in all antitrust conduct investigations except for investigations involving hardcore cartel conduct.
- Under new leniency program rules, the first applicant may no longer receive full immunity, however, the rules guarantee a substantially reduced fine.
- Agreements identified in the AML as monopoly agreements are condemned as per se illegal, whereas the AMEAs bear the burden to conduct a full rule of reason analysis in the case of other potentially unlawful agreements.

- AMEAs are likely to closely scrutinize parallel behavior under the theories of collective dominance and concerted practices.
- The new regulations add justifications that will help companies defend their conduct in abuse of dominance cases.
- SAMR's new supervisory authority over regional AMEAs will likely lead to more consistent application of the AML.

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ENDNOTES

1 The Interim Regulation on Prohibition of Monopoly Agreements ("Monopoly Agreements Regulation"), the Interim Regulation on Prohibition of Abuse of Dominance ("Abuse of Dominance Regulation"), and the Interim Regulation on Preventing Conducts Abusing Administrative Power to Eliminate or Restrict Competition ("Administrative Monopoly Regulation"). SAMR has already released merger filing related rules and guidelines.

2 The new regulations replace five regulations of the State Administration for Industry and Commerce ("SAIC") and though not explicitly provided, it is expected that two regulations promulgated by the National Development and Reform Commission ("NDRC") also will no longer be effective.

3 The new regulations are available in Chinese at http://www.samr.gov.cn/fldj/.

4 One such exception was the recent *Hydron & Horien* (2019) case, in which SAMR's Shanghai branch terminated a resale price maintenance ("RPM") investigation against two contact lenses manufacturers. The decision in Chinese is available at http://www.samr.gov.cn/fldj/tzgg/xzcf/201905/t20190521_293971.html.

5 For more discussion about the slightly different leniency programs under NDRC and SAIC regulation respectively, *see* Jones Day *White Paper* "Combination of China's Three Antitrust Enforcement Agencies May Bring More Aggressive Enforcement Over Long Run", available at https://www.jonesday.com/files/Publication/e1aa9878-9ac0-43a2-a021-a12b535091ae/Preview/PublicationAttachment/cfcbaa9a-4c2c-4a98-ba63-a8b1e6842fb8/Combination_of_Chinas_Three_Antitrust_r2.pdf.

6 The most common illegal vertical agreements under the AML are RPM agreements.

7 Media reports in Chinese on the two cases are available at http://finance.ifeng.com/news/special/yangnaifenlongduan/ and http://finance.people.com.cn/n/2014/0529/c1004-25082732.html.

8 The safe harbor thresholds suggested by previous draft of the regulation were: (i) a combined market share below 15% for horizontal agreements; or (ii) for nonhorizontal agreements, a market share of each party below 25%. However, the safe harbor does not apply to "hardcore" horizontal agreements and RPM under AML.

9 Article 19 of the AML permits a rebuttable presumption of a dominant market position when certain market share thresholds are met—including when the combined market share of two competitors amounts to a 2/3 share in the relevant market, or the combined market share of three competitors amounts to a 3/4 share, excluding undertakings with market shares of less than 10%.