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# Olympic Competition: How China's New Antimonopoly Regime Is Shaping Up

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## **Olympic Competition:**

### **How China's New Antimonopoly Regime Is Shaping Up**

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Olympic competition is not the only form of competition that China will be endorsing this August. On August 1, 2008, China's Antimonopoly Law ("AML") came into effect. Two days later, the State Council's *Regulations on Notification Standards of Concentrations of Undertakings* (the "Merger Filing Rules") was officially promulgated and also made effective. The Merger Filing Rules, which supplement the AML, set out the trigger thresholds for merger filings in China.

In this article, we review the key focal points of the AML and Merger Filing Rules, offer a few criticisms and identify instances where China has deviated from antimonopoly laws in other jurisdictions, and examine challenges facing the AML's enforcement. We conclude with some thoughts on the AML's effectiveness and its potential impact on foreign companies operating in China.

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## **I. KEY AREAS OF FOCUS**

The AML is China's first comprehensive antitrust law and will have a substantial influence on the way in which business is conducted in China. It has three essential focal points:

- (i) to prohibit monopoly arrangements;
- (ii) to prevent abuses of a dominant market position; and
- (iii) to avoid concentrations of undertakings which may have the effect of eliminating or restricting competition.

We discuss each of these in turn in the following sections.

### **A. Monopoly Arrangements**

The AML prohibits competing companies from entering into horizontal business arrangements designed to:

- (i) fix prices;
- (ii) restrict production or sales;
- (iii) allocate or carve up markets;
- (iv) limit the purchase and development of new technologies; or
- (v) boycott transactions.

Also, although quite common in Chinese business practice, vertical monopoly arrangements, such as exclusive supply deals and agreements to fix retail prices or restrict minimum resale prices, are now prohibited.

### **B. Abuse of a Dominant Market Position**

Entities with a dominant market position will not be allowed to engage in activities such as:

- (i) predatory pricing;
- (ii) selling products at an unreasonably low price;
- (iii) refusing to trade;
- (iv) tying and other unreasonable trading terms; and
- (v) discriminatory treatment without proper reasons.

Furthermore, details on what will constitute an “abuse” of a dominant market position are expected to be outlined in pending AML implementing rules, which are likely to be issued in a piecemeal fashion over time.

Under the AML, “dominant market position” refers to the ability to control prices or quantities of products or other transactional conditions in the relevant market, or the ability to block or impact the entry of competitors into the relevant market. Key players should be aware that the AML adopts a rebuttable “presumption of dominance” for set thresholds of market share.

### **C. Review of Concentrations**

Although foreign entities have had to grapple with merger filing requirements in China since the country created a separate set of rules applicable only to acquisitions of domestic business by foreign companies in the 1990s, most of the media attention surrounding the effectiveness of the AML and the Merger Filing Rules has been on their impact on mergers and acquisitions (“M&A”) involving China. The concern is that the new regime, which now applies to both foreign-funded and domestically funded deals, contains more detailed procedures on merger filings and reviews than those previously applied in China, and there are now serious legal consequences for failures to make

required filings, including fines and orders to unwind offending concentrations (e.g., acquisitions, mergers, and so forth).

In addition, the AML, on the one hand, is not applicable to conducts by undertakings to exercise their legitimate intellectual property rights. On the other hand, it also states that “abuse of intellectual property rights to restrict or limit competition” is a component of this AML (clause 55). There are concerns that this clause may be used in a discriminatory fashion against foreign companies who are technology-driven and have relatively larger market shares in certain sectors in China.

## **II. THE MERGER FILING RULES**

### **A. An Overview of the Rules**

The Merger Filing Rules set out the thresholds at which a merger filing must be made to the AML enforcement authority upon a concentration of undertakings. The notification thresholds are now set at:

- A.** (i) the previous financial year’s worldwide turnover of all parties to the concentration in aggregate exceeds RMB 10 billion (approximately USD 1.47 billion),<sup>1</sup>  
and
  - (ii) the previous financial year’s China turnover for each of at least two parties to the concentration respectively exceeds RMB 400 million (approximately USD 59 million);
- or
- B.** (i) the previous financial year’s China turnover of all parties to the concentration in aggregate exceeds RMB 2 billion (approximately USD 290 million),<sup>2</sup>

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<sup>1</sup> Increased from RMB 9 billion in the March 27, 2008 draft Merger Filing Rules.

and  
(ii) the previous financial year's China turnover for each of at least two parties to the concentration respectively exceeds RMB 400 million (approximately USD 59 million).<sup>3</sup>

The Merger Filing Rules has significantly increased the notification thresholds and no longer uses “market share” as a criteria for triggering a merger notification obligation, principally, it seems, due to difficulties with determining market share. There is however a “catch-all” clause in the Merger Filing Rules which allows the State Council’s AML enforcement authority to investigate a concentration which may eliminate or restrict competition even though it does not reach the prescribed notification thresholds.

Also, the Merger Filing Rules state that in respect of the banking, insurance, securities, futures, and other “special industries,” the actual circumstances of the industry should be taken into account in the calculation of the above-stated turnover amounts, and State Council’s designated authority in the relevant industry should implement investigations in this respect according to applicable law.

While the new merger filing regime under the AML and the Merger Filing Rules is clearer than the requirements set for foreign-funded deals previously applicable under Chinese rules, a large number of ambiguities remain and it is widely anticipated that further implementing guidance will be issued in respect of the AML in the near future. That said, Ministry of Commerce (“MOFCOM”) officials have unofficially confirmed

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<sup>2</sup> Increased from RMB 1.7 billion in the March 27, 2008 draft Merger Filing Rules.

<sup>3</sup> Increased from RMB 300 million in the March 27, 2008 draft Merger Filing Rules.

that the proposed notification thresholds will apply on a corporate group basis (i.e., whether or not the other companies in the group conduct business related to that of the transaction target). MOFCOM has also unofficially indicated that if a concentration of business operators is conducted in the form of a newly established entity (e.g., a joint venture), as opposed to an acquisition for instance, then merger filing requirements will not be triggered.

### **B. Shortcomings and Departures from Other Jurisdictions**

There are still a number of criticisms that can be made of the new Merger Filing Rules. First, as there is no reference to a minimum market share in the rules, large multinationals may find that even when they are only acquiring a small Chinese company in an industry in which they do not have any other business activity in China, that they may still be caught by the requirement to file a notification even though the concentration obviously cannot affect market share or competition in China. For instance, with respect to the notification thresholds described in section II.A above, two large foreign enterprises which trigger the thresholds will still be subject to merger filing obligations even if they are collectively targeting acquisition of a small entity in China and the said acquisition is unlikely to impact the competitive environment in which such a target operates.

Second, despite being upwardly revised following public comment, China's turnover thresholds (RMB 400 million) are lower than those of some of the other developed countries and are likely to catch a considerable number of transactions that do

not have a significant impact on competition in China, particularly in the case of the second limb of each of the turnover tests, which provide that individual turnover in the China market in the previous financial year of each of at least two undertakings must exceed RMB 400 million. By way of rough comparison, the thresholds for similar domestic turnover tests in the European Union, United Kingdom, and France are EUR 250 million (approximately RMB 2.5 billion), GBP 70 million (approximately RMB 1 billion), and EUR 50 million (approximately RMB 500 million), respectively.

The rules also imply that, following any filing notification, any concentration's implementation must be suspended until clearance or the expiration of the relevant waiting period. This could cause some serious problems for public bids. Under the preexisting Chinese law, the time limit for a public bid generally cannot exceed 60 days, whereas the maximum timeline for obtaining a merger clearance under the Antimonopoly Law can be as long as 180 days. This could create cases in which the time limit for the public tender bid has expired, and the public bid needs to be closed, but the merger review process has not yet been completed. To avoid this, an exemption for public bids needs to be introduced. Such an exemption is found in many other established merger control systems, for example, the EC merger control system states that the obligation to suspend a concentration until competition clearance has been received must not prevent the implementation of a public bid provided that notification is made without delay and that the acquirer does not exercise its voting rights.



Third, there are also potential problems with the short-term acquisitions of shares by financial institutions. Dealing in shares is an essential part of the daily business activities of many financial institutions around the world which typically acquire shares for investment rather than strategic purposes. They often hold share positions for a short period of time only with the intent to resell them. As the regulations currently stand, without the introduction of a specific exemption, a large number of daily transactions of financial institutions, even those that are only temporary in nature, may become subject to a filing requirement in China. It is of note that many of the other established merger control regimes (including the EC and German merger control regimes) exempt temporary acquisitions by financial institutions from merger filing requirement provided that:

- (i) the shares are held for a short period of time (e.g., no more than one year); and
- (ii) during this period, voting rights are only exercised for the purposes of preparing a resale.

Hopefully a similar exemption into will be introduced in China, especially in view of the low jurisdictional thresholds.

Finally, the rules do not address the question of whether or not the same information requirements will apply both to complex cases and to simple cases which are unlikely to affect domestic competition in any substantial way. It appears that “one-size-fits-all” information requirements which apply irrespective of the domestic effects of a transaction may put a severe and unnecessary administrative burden on many

transactions. Other mature merger control regimes (e.g., the EC merger control regime again) provide for a general “simplified procedure” for transactions that meet certain criteria (e.g., a financial or market share) which usually imply that domestic competition will not be significantly affected. In a simplified procedure, the amount of information or documentation to be provided to the Antimonopoly Enforcement Authority in the context of a notification is greatly reduced.

There is little doubt that a raft of further implementing guidance will emerge with time and will hopefully address the above criticisms.

### **III. ENFORCEMENT**

The question of which regulatory body will be responsible for enforcing the new law has been the subject of some confusion. Ironically, the AML appears to have promoted much competition between various government agencies for the job of enforcing the law. To date, the enforcement of the AML has been divided among MOFCOM for merger filings, the State Administration for Industry and Commerce (“SAIC”) for monopoly arrangements (e.g., tying, restrictive trading, and monopolistic acts by administrations) and abuse of dominant market position, and the National Development and Research Commission (“NDRC”) for price-related matters (e.g., price-fixing, predatory pricing, selling below cost, and so forth).

In this connection, the State Council recently approved the SAIC to set up an antimonopoly and anti-unfair competition executive bureau to undertake functions of drafting antimonopoly and anti-unfair competition measures; enforcing antimonopoly-

related laws and rules and regulations; dealing with cases involving anti-unfair competition, commercial bribery, smuggling, or other economic crimes in the market; as well as supervising the handling of major cases and typical cases in these areas. The State Council also recently reiterated that the Antimonopoly Committee of the State Council will coordinate the three authorities mentioned above in carrying out their AML-related work.

In a further recent development, the Supreme People's Court released a circular requiring the Intellectual Property section of the People's Courts at various levels to handle all civil cases involving AML issues. Clearly the presumption is that judicial officials who are familiar with intellectual property issues are best placed to deal with AML issues, though the logic behind this assumption is sure to be tested in practice.

#### **IV. THE IMPACT ON FOREIGN COMPANIES**

As with many of the laws in China, the effectiveness of the AML will largely be determined by the enforcement and implementation of the law, rather than its substance. It will certainly be interesting to see whether the law is applied equally to foreign enterprises and to state-owned enterprises which still dominate the Chinese economy. It will take time to build up a body of regulation, rules, interpretation, and standard practice to flesh out what currently amount to a mere legal skeleton of antitrust aspirations, and it is still too early to anticipate what impact they will have.

In the meantime, it is advisable for multinationals doing business in China to take proactive and preventive approaches going forward to identify and manage their antitrust

risks in China including the exercise of antitrust audits for their China subsidiaries. Antitrust audits, for instance, could help senior management and in-house counsel examine the existing business activities, contracts, and practices of the company and identify areas of greatest risk under the new antitrust regime. These and other precautionary activities will allow multinational companies to manage or reduce the risks posed by the ambiguities and uncertainties of China's AML.