



# CPI Antitrust Chronicle

January 2012 (2)

**The Application of China's Anti-Monopoly Law to State-Owned Enterprises in Special Industries: The Example of the *China Telecom and China Unicom* Case**

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# The Application of China's Anti-Monopoly Law to State-Owned Enterprises in Special Industries: The Example of the *China Telecom and China Unicom* Case

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## I. INTRODUCTION

In 2011, the Price Supervision and Anti-Monopoly Bureau of the National Development and Reform Commission ("NDRC") initiated an antitrust investigation against China Telecom and China Unicom to examine whether the two companies had abused their dominant market positions by obstructing other businesses from entering the broadband and internet interconnection sector. It was on November 9, 2011, that the state-owned television broadcaster, CCTV, announced the NDRC investigation on its "News 30 Min."

Following that announcement, on December 2, 2011, China Telecom and China Unicom released statements on their official websites noting that they had submitted an application for "suspension of the antitrust investigation." In addition, the two companies acknowledged the existence of inconsistencies between the value of internet connections and corresponding prices, and promised revisions and improvements in internet speed and cost. By December 8, 2011, China Telecom had reportedly made subtle but significant changes to its earlier announcement. As of January 15, 2012, the antitrust investigation against China Telecom and China Unicom was still pending.

In the opinion of some commentators, China Telecom and China Unicom hold a share of over two-thirds in the Chinese internet access market. Combined, the two companies can thus be presumed to have a dominant market position under the Anti-Monopoly Law ("AML"). Moreover, with that dominant market position, the two companies allegedly increased prices for their competitors, but provided preferential treatment to companies that do not compete with them.

Traditionally, in the Chinese internet industry, the structure has been one of China Telecom's dominance in the South, and China Unicom's in the North. In the larger cities, the telecommunications enterprises were found to currently use so-called "black and white lists" of telecommunication enterprises (that is, lists of competitors and non-competitors, respectively) with different prices for each.<sup>2</sup> However, in the view of other observers, there are various internet service providers other than China Telecom and China Unicom in China that can act as a counterweight in the industry, with the result that the two companies under investigation would

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<sup>2</sup> See Luo Lan, *The Anti-Monopoly Investigation on China Telecom and China Unicom*, 2 PEOPLE'S DAILY OVERSEAS EDITION, (November 11, 2011).

not have a dominant market position. Such service providers would include China Mobile, China Railroad Construction Corp., and China Education and Research Network, as well as lease-based value-added telecommunications businesses such as Great Wall Broadband Network and Gehua Cable.<sup>3</sup>

This case has drawn considerable public interest in the AML, and has captivated both academia and the international business community. Standing out among the questions discussed is whether the conduct of China Telecom and China Unicom constitutes an abuse of a dominant market position as prohibited by the AML. However, in addition to this now often discussed question, this antitrust case also exposes a string of other questions about whether the unique situation of state-owned enterprises ("SOEs")—such as China Telecom and China Unicom—should be considered and whether the telecommunications industry has exceptional characteristics that need to be taken into account. Thus, one of the most important questions in the AML enforcement process—which reflects the circumstances specific to China—is how the AML is meant to regulate the conduct of SOEs in special industries.

## II. THE PRINCIPLE OF EQUALITY FOR ANTITRUST REGULATION OF STATE-OWNED ENTERPRISES

SOEs are enterprises that receive some or all of their capital from the State, and are directly or indirectly controlled by it. Hence, a key characteristic of SOEs is their ownership (by the State). In the antitrust investigation against China Telecom and China Unicom in particular, public concern is heavily focused on whether the status of the SOEs affects the way the AML is applied to them.

In reality, the AML does not contain any special provisions clarifying its application toward SOEs.<sup>4</sup> Articles 7 and 31 of the AML have drawn much attention as result of their perceived connection with SOEs. But, as some experts have pointed out, Article 7 provides particular rules for special industries. This provision should not be misinterpreted to mean that it protects SOEs.<sup>5</sup> Moreover, although Article 31 of the AML employs terms such as "foreign investor" and "domestic enterprise," its primary objective is to set up a system to safeguard national security. This is very different from protecting SOEs. Especially with the promulgation of the State Council Circular on the establishment of the new national security review system in 2011,<sup>6</sup> and the implementing provisions issued by the Ministry of Commerce,<sup>7</sup> the independence of the national security review procedure was made clear. As a result, that procedure and the antitrust enforcement procedure are independent of each other.

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<sup>3</sup> See Wang Xiaoye, *China Telecom and China Unicom: Main Legal Questions*, 2 CHINA COMPETITION BULL., (December 7, 2011), available at <http://www.iolaw.org.cn/showArticle.asp?id=3168> (last visited on January 9, 2012).

<sup>4</sup> There are different opinions with the regard to the definition of the term "state-owned enterprise" in both theoretical and practical circles. However, the debate concerning this issue is not the subject of this paper. The definition of "state-owned enterprise" in this paper may be found in SHI JICHUN, *ON THE STATE-OWNED ENTERPRISE LAW*, China Legal Publishing House, at 15 (2007).

<sup>5</sup> See Shi Jianzhong, *The Characteristic, Highlighted System and the Major Deficiencies of the Anti-Monopoly Law of Our Country*, 1 THE JURIST 14-19 (2008).

<sup>6</sup> Circular of the General Office of the State Council concerning the Establishment of a Security Review System for Mergers and Acquisitions of Enterprises within China Involving Foreign Investors, [2011] General Office of the State Council Document No. 6.

<sup>7</sup> Provisions of the Ministry of Commerce on the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, [2011] MOFCOM Notice No. 53.

In addition, the specific circumstances of the Chinese market economy require that the AML do not grant SOEs special treatment. Some scholars have pointed out that, if SOEs maintain their dominant role in the national economy and the AML is not applied to them, then the AML will really be without teeth and will lose its essential meaning.<sup>8</sup> The AML should be applied equally to all types of economic activities. There should not be any exceptions merely on the grounds of companies' ownership or other reasons. Hence, the application of the AML to SOEs is also a question of fairness.

In fact, the AML does not provide any "preferential treatment" for SOEs and, in practice, the enforcement of the AML so far has demonstrated that the principle of equality applies to SOEs. With its initiation of the antitrust investigation against China Telecom and China Unicom, NDRC has sent a strong signal that antitrust laws in China apply equally to SOEs and other business operators alike.

### III. THE PRINCIPLE OF EQUALITY AND THE CASE-BY-CASE PRINCIPLE FOR ANTITRUST REGULATION OF SPECIAL INDUSTRIES

The term "special industries" is not a precise legal concept. Its connotations convey different meanings depending on the perspective taken. Although "special industries" appears to be a more appropriate term to describe certain social and economic activities, in practice "monopoly industries" is a term more frequently used in China.<sup>9</sup>

For the purposes of the AML, special industries are largely defined in accordance with Article 7(1) as "industries vital to the national economy and national security and controlled by the state-owned economy and industries subject to exclusive operations and sales according to the law." In other words, the term "special industries," within the meaning of the AML, refers to industries where specific social and economic policies of the State are carried out and are essential to the national economy, people's livelihoods, and national security, as well as to those industries where companies have been granted by law exclusive rights to provide products or services.<sup>10</sup>

First, special industries are not exempt from the AML and are not granted special treatment under the law. For this reason, special industries should follow the principle of equality under the AML. Particular laws, regulations, or policies—such as the Postal Law, Railway Law, Telecommunications Regulation, etc.—regulate special industries to protect and ensure their development. But these industry-specific rules do not take priority over the AML, and thus cannot exempt special industries from being subject to the AML. Although, as stated above, Article 7(1) of the AML applies to "industries vital to the national economy and national security and controlled by the state-owned economy and industries subject to exclusive operations and sales according to the law," this provision does not mean that the operators' behavior in these

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<sup>8</sup> See Wang Xianlin, *On the Equal Application of China's Anti-Monopoly Law*, 5 LEGAL RESEARCH 17-19 (2007).

<sup>9</sup> In view of the special social and economic policies implemented in such industries, the market structure and circumstances of competition in such industries are also clearly different from those with substantial competition. Therefore, the term "special industries" is more precise than "monopolistic industries."

<sup>10</sup> See Li Wei, *Discussion on the Exceptional Application to Special Industries of Provision on Concentrations between Business Operators under the Anti-Monopoly Law*, 6 J. WUHAN TRAINING INSTITUTE OF AGRICULTURAL BANK OF CHINA 87-88 (2008).

special industries is exempt from the AML due to their special nature.<sup>11</sup> As illustrated by the China Telecom and China Unicom investigation, special industries in China are not excluded from the application of the AML. Hence, operators in these industries, including SOEs, must equally follow the AML's rules when engaging in market activities.

Additionally, in practice, the individual characteristics of each special industry are taken into consideration when the AML is used to adjudicate individual matters, as each case is examined on its own specific merits according to the principle of case-by-case application. Some scholars have suggested that industry-specific regulations in China display many particularities according to the industry concerned, such as the background and the goal of the regulation, the regulator in charge, the regulated subject, the regulated tasks, and content of the regulation, etc.<sup>12</sup>

Government action should take into account the particularities of the industry concerned to adopt appropriate and suitable regulatory measures. In turn, the measures taken will have an impact on the market structure, competition in the market, and the conduct of market players. Therefore, the application of the AML must take into consideration the particular characteristics of the special industries and the specifics of governmental regulation in the industries. In addition, each individual case should be assessed on its own merits.

#### IV. INDIVIDUAL CHARACTERISTICS OF STATE-OWNED ENTERPRISES IN SPECIAL INDUSTRIES UNDER THE AML

The antitrust investigation against China Telecom and China Unicom not only illustrates the equal application of the AML to SOEs engaged in special industries, but also raises questions on how the AML should regulate the market operations of these SOEs.

First, as mentioned above, special industries are frequently referred to as monopoly industries, and—as such—are often subject to rigid control of market access. Therefore, it is relatively easy to find that a business operator active in a special industry has a dominant market position. In the *China Telecom and China Unicom* case, although there have been disputes on how to define the relevant market and on whether China Telecom and China Unicom have a dominant market position, a large part of the comments and discussions focused on whether China Telecom and China Unicom engaged in anticompetitive conduct and whether such conduct was justified. This shows that, under the AML, it seems relatively easy to determine that an operator in a special industry has a dominant market position.

In fact, private litigation under the AML seems to indicate the same. For instance, Article 9 of the Provisions of the Supreme People's Court on Several Issues concerning the Application of the Law in Adjudication of Monopoly-Related Civil Disputes (Draft for Comments) provides that, "if the harmed party produces evidence establishing that the party accused of monopolistic conduct falls under one of the following circumstances, the People's Court may make a preliminary determination that the party accused of monopolistic conduct has a dominant market position, unless the party accused of monopolistic conduct produces evidence to the contrary for a sufficient rebuttal: (1) a public enterprise which supplies water, electricity, heat, gas

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<sup>11</sup> See Meng Yanbei, *On the Principles of Enforcing the Anti-Monopoly Law Concerning Concentrations between Business Operators in Special Industry*, 6 SHANGHAI JIAOTONG UNIV. J. 14-20 (Philosophy and Social Science Ed.) (2010).

<sup>12</sup> See Li Zhengyou, *The Distinctiveness of Reform and the Innovation of Governing Regime with Regards to the Regulation of Natural Monopoly Industries of Our Country*, 6 ACAD. J. OF GANSU 104-108 (2008).

and so forth; (2)business operator other than a public enterprise upon which laws, regulations, rules or other regulatory documents have conferred the qualification to engage in exclusive operations for specific products or services; (3)business operator upon whose provision of products or services trading partners are highly dependent due to a lack of effective competition in the relevant market."<sup>13</sup>

It should be noted that the dominant market position of companies in special industries is lawful because this position was obtained based on the country's special economic policies or specific stipulations of laws and regulations. The purpose of antitrust enforcement under the AML is to prevent the abuse of such a dominant market position, rather than change the structure of competition in the market or question the legality of an existing dominant market position by operators in special industries.

Second, unlike other market players, the autonomy in the management of SOEs in special industries is subject to a double restriction by direct government regulation and oversight through management of State shareholdings. As a result of this double restriction, SOEs usually put forward direct government regulation and management of State shareholding as a defense to justify their conduct. Indeed, the commercial decision-making power may be subject to government regulation, as occurred in the telecommunications industry. On May 24, 2008, NDRC, the Ministry of Industry and Information Technology, and the Ministry of Finance jointly issued the Notice on Deepening the Telecommunications Reform, stating that "based on the current status of the telecommunications industry, in order to realize the objectives of the reform, [we] encourage China Telecom to acquire China Unicom's CDMA network (including assets and users), China Unicom and China Netcom to merge, China Telecom to acquire the basic telecom service units of China Satcom, and China Mobile to acquire China Railcom."<sup>14</sup>

The result of direct government regulation and state-owned share management is that government oversight and market competition become intertwined in special industries. Consequently, antitrust enforcement is frequently confronted with the situation where SOEs in special industries do not have own decision-making power.

Third, when applying the AML to regulate the market behavior of SOEs in special industries, the conduct of the SOEs is often suspected to be "administrative monopoly conduct." The current structure of the markets and the existence of monopolies are not the result of market competition, but rather of the top-down reforms implemented with a strong flavor of administrative planning. This situation raises the question of whether the conduct by SOEs constitutes administrative monopoly conduct, attributable to the government. For instance, the government may provide special support in the form of preferential tax treatment, easy access to infrastructure, supply of important resources, etc. to certain enterprises, and thereby raise entry barriers and costs for the SOEs' rivals.<sup>15</sup> However, even if the privileges enjoyed by SOEs in special industries were the result of an abuse of administrative powers on the part of the

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<sup>13</sup> Provisions of the Supreme People's Court on Several Issues concerning the Application of the Law in Adjudication of Monopoly-Related Civil Disputes (Draft for Comments), 2011, *available at* [http://www.court.gov.cn/gzhd/zqyj/201104/t20110425\\_19850.htm](http://www.court.gov.cn/gzhd/zqyj/201104/t20110425_19850.htm) (last visited on January 9, 2012).

<sup>14</sup> See Wang Yuanfang, *Legal Analysis on the Division of China Telecom—from the perspective of Anti-Monopoly*, 5 CHONGQING UNIV. OF POSTS AND TELECOMMUNICATIONS J. 37-41 (Social Science Edition) (2008).

<sup>15</sup> See Wang Ying, *The Administrative Monopoly of the State-Owned Enterprise and the Anti-Monopoly Law*, 1 THEORETICAL CONSTRUCTION 28-30 (2008).



government, the SOEs would not face any liability under the AML. The only recourse available under the AML is against the governmental conduct.

Fourth, due to the large number of government regulations in special industries, the suspension of proceedings may potentially become one of the typical methods for closing antitrust investigations against SOEs active in such industries. For the antitrust enforcement agencies, investigating an enterprise generally means committing to resolve the case of suspected anticompetitive conduct in a quick and efficient matter, especially if the case is complicated, the illegality of the conduct is not obvious, and the completion of the case is uncertain. The agencies' aim is to resolve such cases before the suspected anticompetitive conduct has caused serious damage to market competition.

Granted, the suspension of proceedings, with commitments on the part of the company under investigation, is not necessarily the best and most natural way of closing an investigation into suspected anticompetitive conduct by SOEs in special industries. However, if cases are closed by means of suspension of proceedings and commitments, this does not necessarily mean that the application of AML is compromised. It simply means that if those cases satisfy the conditions for the suspension of proceedings, the acceptance of commitments is more appropriate to bring the investigation to an end.

The purpose of the AML is not to punish market players, but to protect competition between them. Whether the suspected anticompetitive conduct of SOEs in special industries is subject to a penalty or commitments will require the consideration and determination of the easiest method to achieve this primary objective of the AML. The application of a penalty does not indicate a victory in the application of the AML. Conversely, the suspension of proceedings does not mean that the legislative objective of protecting market competition has been abandoned.

## **V. CHALLENGES AND SOLUTIONS FOR ANTITRUST REGULATION OF STATE-OWNED ENTERPRISES IN SPECIAL INDUSTRIES**

Looking at antitrust laws worldwide, it is clear that their main emphasis is on private entities and not public ones, in particular not SOEs in special industries. Hence, the antitrust experience on the international level provides little guidance on how the AML should regulate such SOEs.

First, the regulation of SOEs in special industries under the AML bears the potential for conflict with price regulation by the government and the problem of coordinating the various regulatory frameworks. If the government intervenes to regulate prices in accordance with the law, such intervention falls outside the scope of the AML. Any unreasonableness may be addressed only through the amendment to the relevant pricing rules. In contrast, where government intervention to regulate prices lacks legal basis or violates procedural rules and has eliminated or restricted competition, such intervention might allegedly constitute administrative monopoly conduct. Still, regardless of whether the government intervention is legal and reasonable, the SOEs in special industries should not bear any liability under the AML.

Where the government sets the prices of products or services, SOEs do not have autonomous pricing power. Therefore, it would be impossible for them to be held liable for price monopoly conduct. For the products or services with government-guided prices, SOEs have a limited degree of autonomy in their pricing power. Hence, the likelihood for them to engage in anticompetitive pricing behavior is relatively low. In contrast, where the products or services are

set freely by market forces, SOEs in special industries have the potential, with a relatively high likelihood, that their conduct could constitute anticompetitive pricing conduct.

In the *China Telecom and China Unicom* case, the Telecommunications Regulation provides that the calculation and allocation of interconnection fees are to comply with the relevant State regulations, and no fees other than those stipulated in the regulations shall be charged. Measures for the calculation of fees and other implementing provisions are to be formulated by the competent supervisory department—*i.e.*, the Ministry of Industry and Information Technology. Therefore, one of the key questions of this case is how much autonomous pricing power the two companies have in setting prices. If a company has no autonomous power to set prices, the solution is to require the relevant supervisory department to lower the ceiling of the fees to be charged by the leading telecommunications operators. If the company retains all, or some, capacity to autonomously set prices in its business operations, then it is necessary to apply the AML to the actions of the company and determine if such actions constitute an abuse of a dominant market position as prohibited by the AML.

In any event, when applying the AML to price-related anticompetitive conduct by SOEs in special industries, the law should be applied appropriately to prevent antitrust enforcement from turning into price regulation and control.

Second, the application of the AML to SOEs in special industries also risks conflicting with industry-specific regulation and plans by the government. Apart from aiming to safeguard market competition, the government also pursues the goals of economic security, industrial development, fairness and justice, etc. If there is a conflict between these goals, the government may well do all it can to safeguard and protect competition. But, in the case of conflict, it also becomes increasingly important to coordinate the industry-specific regulation with antitrust enforcement.

To illustrate this point, in the *China Telecom and China Unicom* case, the announcement by China Telecom to change the conduct was still questioned after its release. In the revised version of the announcement, China Telecom stated that it had "carefully studied the related laws and regulations such as the Anti-Monopoly Law and the Telecommunications Regulation." In the original version of the announcement, by contrast, the Telecommunications Regulation was not mentioned. Furthermore, with regard to the dedicated internet access business, the original wording of the announcement stated that "price management was not in place and large price differences existed," while the revised announcement noted that "large price differences existed as a result of competition and management."<sup>16</sup> To a certain extent, the revision of the announcement indicates the relatively high potential for conflict between antitrust and industry-specific regulation.

Therefore, when establishing and implementing the regulatory framework for a special industry, there is a clear need for coordination between antitrust and industry-specific regulation. In any event, it is necessary to maintain the vigor of antitrust enforcement, but avoid having antitrust enforcement agencies play the role of sector regulators.

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<sup>16</sup> See Jingjing Zhong & Jin Zhao, *China Telecom silently changed its statement on the antitrust case: an indication of not violating the law*, available at <http://tech.sina.com.cn/t/2011-12-09/02366457175.shtml> (last visited on January 9, 2012)



Third, the AML has its own legislative aims, and cannot address all of the manifold problems facing the regulation of SOEs in special industries; these problems require further study. Article 1 of the AML states that “this law is enacted for the purposes of preventing and prohibiting monopolistic conduct, protecting fair market competition, promoting efficiency of economic operations, safeguarding consumer welfare and the public interest, and promoting the healthy development of the socialist market economy.” The key aim of the AML is thus to maintain and protect competition and, through this, further the development of the national economy and maximize overall welfare to society.

SOEs in special industries face many problems, and these problems should be properly categorized and analyzed. Some may be solved through the enforcement of the AML, while others should be tackled through the simultaneous enforcement of the AML and other laws. Finally, some problems can only be addressed on the basis of enforcement of other laws or further reform measures. For the *China Telecom and China Unicom* case, for example, the issues that have drawn widespread attention are interconnection and interoperability, the integration of the three networks (*i.e.*, television, telephony, and the internet), and the lack of sufficient competition in the telecommunications industry. It is very hard to solve the issues arising from the case solely through enforcement of the AML.

## VI. CONCLUSIONS

The AML is confined to a limited role in solving the problems confronting SOEs in special industries. The telecommunications sector is an industry subject to strict control by the government, with several insufficient reforms and plenty of distorted systems and mechanisms. The enforcement of the AML in such an industry is unable to solve all the related issues. Of course, antitrust enforcement will certainly encourage and promote reform of the telecommunications industry. But, at the same time, the limitations of the application of the AML to SOEs in special industries also reveal the necessity and urgency to deepen the reform of the telecommunications sector and the special industries as a whole.