

China's competition regulators to target pricing and market power abuse

China's National Development and Reform Commission ("NDRC") and the State Administration for Industry and Commerce ("SAIC") have issued a swathe of new rules on anti-competitive agreements and abuse of dominance, giving teeth to the final two pillars of its Anti-Monopoly Law ("AML").

Since the AML's introduction in August 2008, much of the precedent and practice issued has focused on the merger control regime. This latest focus on the two remaining traditional pillars of an antitrust regime has long been awaited. The new rules come into effect on 1 February 2011.

Anyone with business in China should be aware of the new rules, as they cover day-to-day activities such as pricing, sales, supply chain and distribution.

The new rules also create grey areas of their own in some areas, and with two regulators – the NDRC and the SAIC – issuing two sets of rules, the potential for jurisdictional conflicts also arises.

This briefing explains the rules, and looks at some of the potential problems with enforcement and compliance.

The NDRC Rules

The NDRC, on 4 January 2011, published rules on price-related anti-competitive commercial practices:

- Rules on the Prevention and Restriction of Price-related Monopoly Conduct (the NDRC Rules); and related
- Procedural Rules on Administrative Law Enforcement against Price Monopoly (the NDRC Procedural Rules).

China's AML empowers the NDRC to enforce the AML against price-related anti-competitive conduct (eg price-fixing cartels), price-related abuses of a dominant position and abuse of administrative power through price-related activities.

The NDRC Rules are the first price-related regulations published by the NDRC. They provide insight on the regulator's approach to price-related infringements, and clarify and address many concerns raised by the previous draft rules published in August 2009 for public comment. The rules apply to anti-competitive pricing agreements (or monopoly agreements as they are known under the AML), abusive pricing practices adopted by dominant companies, as well as abuse of administrative power.

Price-related monopoly agreements

The NDRC Rules clarify the kinds of anti-competitive conduct between competitors and conduct between companies and business partners (such as suppliers and distributors) that the NDRC will investigate. The rules focus on conduct between competitors, signalling the NDRC's enforcement priority going-forward.

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The provisions prohibit agreements, decisions or concerted practices that result in price-fixing. Concerted practice is broadly defined to include evidence of parallel pricing and information exchanges between companies concerning (price) intentions. The rules indicate that the NDRC will also consider market structure and market trends in determining whether companies have acted in concert.

Evidence of parallel price increases – without evidence of communications between the relevant companies – could potentially suffice to raise concerns under the provisions. Companies could thus face investigation simply because they acted rationally and unilaterally to external market forces (eg an increase in input costs) in the same way as their rivals. Agencies in other jurisdictions (such as the EU and the US) generally require evidence of actual cooperation and not just parallel behaviour for a finding of unlawful conduct.

The NDRC Rules also provide examples of pricing practices between competitors that are prohibited. The list includes fixing or changing the price of products or services; fixing or changing the level of price variations of products or services; fixing or changing handling fees or discounts that affect prices; adopting agreed prices as a benchmark for dealings with third parties; adopting a standard formula for price calculations; stipulating that price changes will not be implemented without the consent of competing companies party to the agreement; or disguised forms of price fixing (eg limiting production or sales so as to maintain artificially high prices). The rules make clear that the prohibition extends not only to the fixing of absolute prices but also to coordination on the level of price increases, handling charges, discounts and tariffs or rates that serve as negotiation platforms with customers.

For companies operating at different levels of the supply chain, only the fixing of resale prices or setting a minimum resale price are expressly prohibited by the NDRC Rules. This does not mean that other restrictions typically found in vertical agreements are permissible. The NDRC has discretion to identify other categories of prohibited conduct.

Special attention is paid to trade associations, which, in recent months, have instigated or facilitated price cartels that the NDRC has investigated albeit generally under the existing Price Law (eg rice noodles, green beans, garlic and paper cartels). The NDRC Rules expressly prohibit trade associations from adopting anti-competitive rules, decisions or notices, or from encouraging anti-competitive agreements between members.

Abuse of dominance through price related conduct

The NDRC Rules define a dominant position as having the ability to control price, quantity and other trading terms such as payment methods, or undermine market entry. Dominance is presumed where a company has a market share of 50 per cent as well as where two companies account for two-thirds of the market or three companies account for three-quarters of the market. The presumption does not apply to a company with a market share of less than 10 per cent.

The provisions also list prohibited pricing practices for dominant companies. The catalogue of prohibited practices reflect a mixture of exploitative and exclusionary abuses such as selling at unfairly high prices or purchasing at unfairly low prices; selling below cost; refusing to deal by setting excessively high or low prices; exclusive dealing through discounts; adding unreasonable fees to prices; and price discrimination.

Apart from unfairly high prices or purchasing at unfairly low prices and adding unreasonable fees to prices, abuse can be ruled out if the dominant company concerned can point to permissible justifications for the practice. Examples in the NDRC Rules include the promotion of new products for below-cost pricing; the existence of comparable or alternative suppliers for refusals to deal; and ensuring product quality or safety, brand image protection for exclusive dealing through discounts.

The NDRC has wide discretion in determining what constitutes an unfairly high or low price. The NDRC Rules explain that the NDRC will consider market trends such as whether the price is significantly higher or lower than the price at which other companies sell or purchase the same goods or services. The NDRC will also consider whether any increases in sale prices or reductions in purchase prices are significantly lower or higher than cost increases or reductions and, if costs are stable, whether increases in sale prices or reductions in purchase prices exceed the normal range. However, the NDRC Rules do not specify the cost components that the NDRC may take into account, nor do they offer guidance on the cost benchmarks or standard that the NDRC is likely to use.

The SAIC Rules

The SAIC, which is responsible for the enforcement of the AML against non-price related conduct, followed the NDRC with the publication of three substantive rules on 7 January 2011:

- Rules on the Prohibition of Monopoly Agreements (SAIC Monopoly Agreements Rules);
- Rules on the Prohibition of Abuse of Dominant Market Position (SAIC Dominant Position Rules); and
- Rules on the Prohibition of Abuse of Administrative Power resulting in the elimination or restriction of competition.

The SAIC rules follow the publication of draft provisions for public comment in May 2010 (an earlier draft of rules on anti-competitive agreements and abuse of dominant position was published in 2009).

Non-price related monopoly agreements

The SAIC Monopoly Agreement Rules clarify the types of agreements and concerted practices that are prohibited under the AML. The provisions mainly address commercial practices between competitors but provide a catch-all prohibition against anti-competitive agreements that may apply to companies operating at different levels of the supply chain.

Like the parallel provisions under the NDRC Rules, the SAIC Monopoly Agreements Rules also apply to concerted practices. The SAIC provisions provide additional specificity and clarify that a concerted practice requires evidence of parallel behaviour as well as actual cooperation between companies. The SAIC will also consider reasonable explanations given by the companies concerned for the suspected coordinated conduct.

Prohibited activities include production or sales restrictions; market sharing or customer allocation and allocation of raw materials procurement markets or suppliers; restrictions on the development, purchase, investment or use of new technologies, techniques and equipment and acceptance of new technical standards; and joint boycotts of customers or suppliers. The SAIC provisions, like the NDRC Rules, also sanction anti-competitive practices organised, encouraged or facilitated by industry associations.

Abuse of dominance through non-price related conduct

Like the NDRC Rules, dominance is presumed under the SAIC Dominant Position Rules where a company has a market share of 50 per cent and where two companies hold two-thirds of the market or three companies hold three-quarters of the market. The presumption does not apply to a company with a market share of less than 10 per cent.

The SAIC Dominant Position Rules also define a dominant position as having the ability to control price, quantity and other trading terms such as quality, or undermine market entry but there are some differences with the NDRC Rules. For example, other trading terms is defined more narrowly under the SAIC's provisions.

Further, dominance is determined by reference to a more detailed list of indicia related to the market share of the company(ies) concerned; the competitive dynamics of the relevant market; the ability to control supply or purchasing markets; financial strength and technical capabilities; the extent to which it is relied on by other businesses; and market entry barriers. This is an improvement on the earlier versions of the rules, which focused almost entirely on market share.

The SAIC provisions also provide a non-exhaustive list of practices that constitute abuse within the meaning of the AML. This includes refusal to supply (including denying access to essential facilities or by reducing sales or through delays); imposing exclusive dealing obligations; tying; imposing unreasonable terms; and discrimination.

These practices are consistent with abusive practices found in other jurisdictions. However, certain practices such as restrictions on payment methods, which other major jurisdictions do not normally regard as abusive, raise the prospect of possible divergences with international practice. Companies bear the burden of justifying suspected unlawful conduct. Unlike the NDRC Rules, the SAIC provisions offer little guidance on permissible justifications.

What the new rules mean for enforcement practice

The NDRC and the SAIC Rules usefully clarify the types of anti-competitive practices that may be subject to regulatory scrutiny. Prohibited activities such as price-fixing, fixing resale prices or setting minimum resale prices in distribution contracts, production or sales restrictions, market sharing or customer allocation are broadly consistent with prohibitions against such practices in other major jurisdictions.

However, ambiguities remain and equally there is ample scope for jurisdictional conflicts to arise between the NDRC and the SAIC, as well as divergences in practice and procedure.

Enforcement

There are sources of ambiguity in the various rules. For example, the application of the AML to IPRs or new technologies remains unclear, and could call into question established technology licensing practices and existing approaches to standards. The SAIC is understood to be drafting provisions to clarify the interaction between IPRs and competition law.

The extent to which state-owned enterprises (SOEs) are subject to the prohibition of anti-competitive conduct is also unclear – whereas the NDRC Rules include a specific prohibition on SOEs, the SAIC rules do not. A recent investigation by the NDRC's Hubei Price Bureau, involving tying the sale of table salt to a local brand of washing powder, suggests that the NDRC will enforce the AML against companies with exclusive rights or SOEs that engage in exploitative conduct that ultimately harms consumers.

At the procedural level, differences in enforcement priorities could emerge. Both the SAIC and the NDRC envisage delegating enforcement of the AML to local authorities. Unlike the case-by-case approach adopted by the SAIC, the NDRC provisions anticipate a more flexible approach and generally delegate power to pricing authorities at provincial level to enable them to handle cases within their respective administrative area. The delegation of powers will fuel enforcement at local level, potentially resulting in important disparities in practice and policy between agencies.

Penalties and leniency regime

The NDRC Procedural Rules clarify the enforcement powers of the central and local enforcement authorities; explain investigation procedures (including the right to conduct interviews and request information, to enter business premises, to review and copy documents); and indicate penalties for companies that infringe the AML (ranging from a fine to possible criminal sanctions if the conduct is criminal in nature) and for companies or individuals that do not cooperate with the investigation. The NDRC Procedural Rules also provide guidance on leniency applications, commitment procedures and the different levels of immunity that a company may receive.

The SAIC adopted procedural rules in 2009 concerning non-price related anti-competitive conduct. Although similar to the NDRC Procedural Rules, there are differences between the two sets of rules. For example, whilst both sets of procedural provisions indicate that the first company that reports anti-competitive conduct may receive full immunity, the NDRC Procedural Rules go further by specifying the level of immunity that the second and third company reporting anti-competitive conduct may obtain. The extent of eventual fine reductions remain at each authority's discretion, raising the prospect of possible divergences in fining practice between the two enforcement agencies in the future.

Jurisdictional conflicts between the NDRC and the SAIC

In practice, it may prove difficult to distinguish clearly between price and non-price related infringements. In economic terms, there is little difference between an agreement to limit output and a price-fixing agreement. Similarly, a refusal to supply goods or services is not materially different from supplying goods or services at excessively high prices.

However, there is little guidance on which agency will take the lead when conflicts arise over jurisdiction. This could potentially result in parallel investigations concerning the same conduct. Although it is understood that certain internal working rules exist to facilitate coordination between the agencies, it remains to be seen how this will apply in practice.

What the new rules mean for business

The respective Rules adopted by the NDRC and the SAIC are potentially far-reaching and, if enforced, may call into question certain commercial practices that have thus far been permissible in China.

To date, China's enforcement agencies have shown considerable restraint in enforcing the AML, preferring to rely on related laws such as the Price Law or Unfair Competition Law where an enforcement tradition already exists. The new rules may spur investigations under the AML, especially at local authority level, as China's regulators seek to curb artificial price increases and cartels, including those led by trade associations, in key industries.

Unlawful conduct can attract considerable fines (up to 10 percent of global turnover) and, in certain cases, criminal sanctions. Companies, especially dominant companies, are well advised to ensure compliance with the AML and related laws. Companies should also examine existing commercial practices and assess whether they are consistent with the examples of permissible conduct outlined in the new rules.

The delegation of power to local enforcement agencies will encourage enforcement at local level, potentially leading to divergences in practice in important areas such as enforcement, fining policy and leniency applications.

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