

REFLECTIONS ON CHINA’S NEW ANTI-MONOPOLY LAW
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A month from tomorrow, on August 1, 2008, the People’s Republic of China will join the ranks of roughly one hundred nations that enforce antitrust laws. It has been thirty years since Deng Xiaoping began to remake China’s economy from a “planned economy” to an economy based on market principles. A modern competition law has been consistently asserted by Chinese officials as the next logical step in this ongoing liberalization process. The results of this shift have been impressive indeed. By now a fully awakened giant, China is currently the second largest trading partner of both the European Union and the United States. Therefore, it is not surprising that the soon-to-take-effect Anti-Monopoly Law (“AML” or “The Law”) is drawing much attention from antitrust agencies and practitioners on both sides of the Atlantic.

I would like to begin with a few general remarks on the process through which the AML was adopted, after which I will offer a few observations on the Law’s substantive provisions, as well as on a proposed set of pre-merger notification regulations under the Law, that were published in March this year. In these remarks, I speak for myself, not necessarily for my agency or any of its Commissioners. I would also like to thank Randolph Tritell, Director of the FTC Office of International Affairs, for his assistance and guidance in preparing these remarks.

General Remarks

I begin my general remarks by complimenting the relatively transparent manner by which China has developed the AML. During the past several years, the US antitrust

agencies have had repeated opportunities to provide comments and suggestions on successive drafts of the Law. Through informal, formal, bilateral, and multilateral contacts, the Chinese agencies and legislature involved in the drafting process obtained a wide variety of views on the Law's proposed provisions from the public and private sectors in China and abroad. We at the U.S. agencies were very pleased with this transparency, which allowed us to work closely with our counterparts in China. We also were pleased to see, in successive drafts, several changes to the Law that are consistent with positions that the U.S. agencies have advocated. For example, early drafts contained provisions that appeared to condone collusion in the context of trade associations. Our concerns about these provisions in earlier drafts have been alleviated by new provisions that clarify that collusion within trade associations is unlawful.

Second, and directly emanating from the relative transparency of the AML's legislation process, I believe China has greatly benefited from the experience of the U.S. agencies and others. In a famous quote, U.S. Supreme Court Justice Oliver Wendell Holmes, Jr., once observed that "the life of the law has not been logic; it has been experience." Indeed, in speaking about our U.S. experience, we were able to relate to the Chinese not only what we now regard as sound antitrust policy, but also the process by which we arrived to where we are today, which was not a straight line but rather replete with many missteps and policies that we now view as misguided. Such lessons, learned the hard way through experience, can be very useful both at home and abroad, to help avoid the same missteps.

I recognize that China, like other countries with new antitrust regimes, will ultimately fine-tune and implement its Law in a way it feels best suits its specific circumstances. In doing so, China's antitrust enforcers also are likely to make their own mistakes and correct them as they go. This is, indeed, the only way to gain the genuine experience-derived legal knowledge of which Justice Wendell Holmes spoke. Nonetheless, hearing often consistent messages from the U.S, the EU, private bar, and others' experience, has likely spared China at least some costly missteps it might otherwise have taken.

Third, and dovetailing with the previous remarks, I'm delighted to note that the U.S. agencies' ongoing contacts with our Chinese counterparts have allowed us to develop

an excellent mutual working relationship. Despite the different cultural and market starting points, we have found our Chinese counterparts quite open to our comments and suggestions, and are already beginning to see early signs of cooperation with them of the type we have fully developed with other antitrust agencies. We look forward to continuing to work closely with the forthcoming antitrust enforcement authority.

Fourth, I note that, since the AML has not yet taken effect, nobody really knows how its implementation will play out. Such uncertainty raises concerns, especially since the Law's stated goals, include "safeguarding fair...competition," "protecting public interests," "promoting the healthy development of the socialist market economy," and ensuring an "orderly market system"¹ – all concepts that are quite different from today's widely acknowledged principles of antitrust law. Adding to the uncertainty is the fact that, at the time I submitted my written remarks, we did not know yet what agency or agencies will be responsible for enforcing the Law. We also do not know whether parties will be expected to comply fully with the Law, subject to penalties, as of August 1, or whether there will be any phase-in period for compliance. Potentially, conduct undertaken today may become subject to the Law come August 1. Furthermore, the Law designates an Anti-Monopoly Commission at the State Council level, but there has not yet, to our knowledge, been a designation of the responsible law enforcement agency or agencies. In short, there are still many unknown variables in this unfolding story, and we look forward to learning more in the near future.

Finally, my last general remark calls for caution. The adoption of a competition law presents both opportunities and risks. A properly designed and implemented law can bring significant benefits and play an important role in the transition to a market-based economy. A well-designed and implemented competition law can result in lower prices, greater output, better quality, and enhanced innovation, all to the benefit of domestic consumers as well as the economy as a whole.

At the same time, however, the application of competition law entails many potential pitfalls. As we know, it can be difficult to distinguish some types of anticompetitive conduct from vigorous competition on the merits. Even an experienced agency can adopt policies and bring cases that appear, *ex post facto*, to have been

¹ See §§ 1 and 4 of the AML.

unwarranted because they diminish consumer welfare and distort the competitive process, and the risk of mistakes is of course exacerbated when an agency is just beginning to enforce a new law.

A competition enforcement system often attracts complainants seeking to use it to restrain their rivals, to the detriment of consumers. Political forces may also seek to influence an agency's enforcement agenda based on non-competition social goals, or even to favor domestic over foreign firms. Competition policy can become a handmaiden to related but ultimately incompatible objectives, such as the creation of national champions through industrial policy.

Despite the often scholarly appearance of antitrust enforcers, an antitrust enforcement regime is a very powerful tool. Although anti-competitive conduct harms consumers, over-enforcement of antitrust laws leads to significant false positive results that can chill pro-competitive behavior to the detriment of consumers. In speaking of dangerous endeavors, Chairman Mao has once advised that: "In waking a tiger, use a long stick." In a similar fashion, I would advocate a healthy measure of caution by China's nascent antitrust enforcers. As they begin to enforce their new Law, they need to take care not to over-enforce their new law in a manner that may disadvantage their consumers, and ultimately their economy.

From these general remarks, I move to comment on some of the Law's substantive provisions.

Substantive Remarks

The AML's language is not very different from other that of other modern antitrust laws. It contains provisions dealing with: agreements between competitors; the exercise of monopoly power; a system of pre-merger notification and substantive merger review; investigation processes; and remedial provisions. Some of the Law's provisions look much like provisions of U.S. law, some mirror European provisions, and others seem to have a uniquely Chinese character. Many of the provisions are very general, which has been a source of some concern. However, broad statutory provisions that remain to be interpreted are quite common, including of course in the U.S. antitrust laws and, as such,

have a potential benefit of being adaptable to changes in legal and economic thinking over time.

My comments today will focus on the AML provisions dealing with merger review, abuse of intellectual property, unilateral conduct, and state owned enterprises, and on the provisions of a recently published set of draft regulations, under the AML, dealing with pre-merger notification.

Merger Review – General

We are, of course, pleased that merger review under the AML will apply equally to all transactions. This replaces the current regime under which China reviews only certain transactions involving foreign parties pursuant to the merger review provisions of the Foreign Investment Law.

Overall, the AML's merger review standards seem in line with those in other jurisdictions - the ultimate test being whether the transaction has or may have the effect of eliminating or restricting competition (Art. 28). Most of the factors for evaluating this test are similar to those used in the U.S. and elsewhere. However, Article 27's list of factors includes the merger's "effect...on the development of the national economy," and "other factors affecting the market competition that the AML Enforcement Authority deems relevant." What will these criteria mean?

In a March 1, 2008 speech, the Chairman of the NPC Legal Affairs Committee said, "The AML needs to coordinate with Chinese industrial policy and other policies, like the policy to foster large (domestic) enterprises and groups so that they could gain international competitiveness, and considerations on national economic development and technical progress."

It is our view that applying a competition test to mergers is not only the correct way to apply competition policy (otherwise they wouldn't call it "competition policy"), but also the best way to promote competitiveness, and enhance economic development and innovation. We hope China's antitrust enforcers will stay true to a competitive analysis standard; otherwise its economy may suffer the consequences brought about by going down the industrial policy path.

Pre-Merger Notification Draft Regulations

As part of the relative transparency I mentioned earlier, in March this year the Legislative Affairs Office of China's State Council (SCLAO) published draft pre-merger notification regulations under the AML, to solicit public comments on them prior to adoption. These draft regulations add much needed clarity to the upcoming implementation of the AML's merger regime, and we were pleased to see that their local nexus requirements substantially conform to the ICN Recommended Practice for Merger Notification Procedures relating to local nexus,² which provides that jurisdiction should be asserted only over transactions that have an appropriate nexus with the jurisdiction concerned – i.e., those that are likely to have an appreciable effect on competition within the territory. Nonetheless, we believe the draft regulations could use improvements and raise some concerns, three of which I would like to highlight.

First, Art. 3(3) of the draft rules suggested a notification threshold for deals resulting in an aggregated market share exceeding 25%. We strongly advocate against the use of such a threshold because it is not objectively quantifiable. The worldwide experience with premerger notification requirements, as reflected in the ICN's Recommended Practices for Merger Notification Procedures,³ suggests that merger notification thresholds need to be clear, understandable, and based on objectively quantifiable criteria. A market share threshold does not meet these criteria because calculation of market shares presupposes that there is a clear understanding of the relevant product and geographic markets affected by the concentration, which is seldom the case. The determination of the relevant market is often a highly complex task, and therefore the parties to a merger transaction are likely to be unsure whether their transaction triggers this threshold.

A second source of concern is the translation requirement. Art. 10 of the draft regulations requires that all documents and materials be translated into Chinese. It is common for jurisdictions to require the notification form be filed in their official language, however requiring translation of all supporting documents may impose very high costs on

² Practice I. The practices are available at: <http://www.internationalcompetitionnetwork.org/media/archive0611/mnprecpactices.pdf>.

³ Practices II.A & B, see *id.*

notifying parties and likely will also cause significant delay. Such huge costs and delays are especially wasteful given that most notified transactions will not raise any competitive concerns. Furthermore, a delay can be especially problematic for parties attempting to clear a deal simultaneously in many jurisdictions, as is often the case these days.

The ICN Recommended Practices⁴ address this problem by recommending that jurisdictions limit translation requirements by not requiring extensive translation of supporting documents, such as transactional materials and annual reports as part of the initial notification requirements. The Recommended Practice provides that competition agencies should accept translated summaries, excerpts, and other means of reducing translation burdens, without prejudice to their ability to require full translations if the transaction appears to present competitive concerns.

I would recommend that the AML merger notification regulations follow this pragmatic ICN recommendation, by limiting translation requirements to the notification form, and any existing translations of documents called for. The U.S. agencies also follow this ICN recommendation, by minimizing the translation requirements at the initial reporting stage to include only existing document translations or English summaries.

Finally, a third concern mentioned earlier, is that the draft regulations do not set out a phasing-in period. While the AML will take effect in one month, its final pre-merger notification regulations have not been published yet. It is unclear how merger transactions that currently are being negotiated, and which may close on or shortly after August 1, will be transitioned.

The U.S. agencies encountered a similar issue when we adopted our pre-merger notification law, the Hart-Scott-Rodino (“HSR”) Act. The HSR Act was signed into law on September 30, 1976, but it was not until September 5, 1978 that its rules took effect. Transactions consummated between these two dates were exempt from the Act pursuant to a “transitional rule” adopted by the FTC in 1977, that also included additional phasing-in details. I would suggest that Chinese pre-merger filing rules also consider providing a transitional rule that will “grandfather” existing transactions and provide much needed details of its initiation.

⁴ Practice V.D, see *id.*

Antitrust-Intellectual Property Issues

The AML's only reference to IP rights is in Article 55, which says the although the Law is inapplicable to the exercise of intellectual property rights pursuant to provisions of laws and administrative regulations relating to intellectual property rights, it does apply to "conduct that eliminates or restricts competition by abusing IP rights."

Although facially neutral, Art. 55 has created a tremendous amount of anxiety in the business community, because it does not clarify the meaning of the term "abuse of IP rights." It also plays into broader concerns regarding the treatment of intellectual property rights in China, particularly those held by non-Chinese owners. Apparently, this area of the AML is receiving as much attention in China as it does abroad. Earlier this month, in announcing its National IPR Strategy, China's State Council identified "preventing IP abuse" as one of the Strategy's five key focuses.

One area of concern in this regard is how licensing practices, including refusal to license, will be treated by the AML. Many are also concerned about the possibility that the AML could be used to impose compulsory licensing. Clarification that the AML does not condemn just any "abuse of IP rights" but, rather, that a violation under Art. 55 requires a finding that some provision of the Law's prohibitions relating to agreements or dominance has been infringed, would be helpful. In so doing, China would apply the same legal analysis for antitrust issues relating to intellectual property as it does to other types of allegedly anticompetitive conduct. In the longer term, more detailed guidelines in this area would also be useful.

Unilateral Conduct Provisions

In line with the unilateral conduct antitrust rules in the U.S. and other jurisdictions, the AML does not condemn the possession of a dominant market position as such, but, rather, only prohibits the abuse of dominance. With respect to establishing dominance, AML Art. 19 creates presumptions of dominance based on market shares - when a single firm holds a market share of 50%, two firms have a combined market share of 2/3, or three firms have a combined share of 75%. The Law now makes clear that these presumptions are rebuttable, heeding earlier concerns that they may be conclusive in nature. This formulation is also in line with the ICN's recent Recommended Practices on

Dominance/Substantial Market Power Analysis pursuant to Unilateral Conduct Laws. Adopted earlier this spring at the ICN's 7th Annual conference in Kyoto, the practices recommend that "agenc(ies) should remain receptive toward evidence that may overcome the [market share based] presumption (e.g. that the market operates competitively)."⁵

We are quite skeptical of market share based dominance presumptions, which can overemphasize market structure in a unilateral conduct analysis. Our experience has been that a presumption of this type can yield erroneous conclusions, because there are further criteria that need to be considered. The ICN's Unilateral Conduct Recommended Practices I just mentioned reflect a shared understanding that market share is only a starting point for the analysis of dominance, being only one of many other market factors that should be analyzed, such as barriers to entry and expansion and other criteria depending on the circumstances (e.g. buyer power, economies of scale, network effects, etc.).⁶ The AML does note various factors that must be considered to find dominance. The law appears to place the burden of overcoming the presumptions on the parties. I hope that the China's enforcement agency will apply the dominance provisions in line with the ICN's recommended practices, so as to ensure that only firms holding a truly substantial and durable market power will be found dominant. This also applies to the collective dominance provisions which, while found in European and other laws, are alien to the U.S. system.

AML's Application towards State Owned Enterprises (SOEs)

Art. 7 of the AML provides that the State shall protect the legitimate business activities of undertakings in industries that "are controlled by the State-owned economy and are critical to the well-being of the national economy and national security" as well as "industries that conduct exclusive and monopolistic sales in accordance with law." At the same time, Art. 7 mandates that these "protected" entities shall "conduct their business in accordance with [the] law in an honest and trustworthy manner, impose strict self-discipline, and accept supervision from the public," and that they "shall not harm the interests of consumers by making use of their position of control or their position of

⁵ Practice 6, comment 1. The Unilateral Conduct Recommended Practices are available at: http://www.internationalcompetitionnetwork.org/media/library/unilateral_conduct/Unilateral_WG_1.pdf.

⁶ Practices 6, 7, and 8, *id.*

exclusive and monopolistic sales.” Most of these terms are foreign to U.S. competition law enforcers, and we are not sure what to make of them.

The scope of Art. 7 is also unclear. Will it be interpreted to cover entire industries or, rather, individual SOEs? Who will be protected against what and against whom? Does “lawful operation” refer to the provisions of the AML or to other rules? These questions and others remain unanswered. In any event, concerns that Art. 7 would be used to justify lesser or no antitrust scrutiny of SOEs is intensified by official statements, such as the March 1 speech I mentioned earlier, in which the NPC official said, “The AML is designed to safeguard the Chinese fundamental economic system. It should take into account the demands of SOEs to grow bigger and stronger, increasing the degree of their industrial concentration and building up their competitiveness.” Time will tell whether this concern was warranted, and I deeply hope it will not be, as experience shows that government-imposed restraints often prove to be particularly durable, and can have a greater adverse effect on the economy than private restraints.

Conclusion

In implementing and enforcing the new AML, our Chinese counterparts will face a daunting task. They will have to navigate the often conflicting demands of local businesses, foreign investors, powerful state owned enterprises, consumers, and central, local, and foreign governments. On the practical level, they will have to issue detailed implementing regulations that will guide the business community as to how to adhere to the AML, set up enforcement institutions, train staff, deal internally with other agencies who may have conflicting views on how antitrust laws should be enforced, etc.

While none of these tasks is easy, now is not a time to despair. Chairman Mao once said that “in time of difficulties, we must not lose sight of our achievements.” An avid believer in the “planned economy,” one of whose famous articles was entitled “Opposing Liberalism,” Mao would probably not have regarded the AML as an achievement. Nonetheless, we live in different times. China’s economy and consumers are beginning to reap the benefits from the country’s ongoing evolution toward a market economy, and a sophisticated antitrust law supporting the same, should be saluted.

The U.S. agencies stand ready to assist our Chinese counterparts in whatever way we can, as they go about implementing their new Law. We hope that they will learn from the hard lessons we have learnt throughout many years of antitrust enforcement, e.g. that competition agencies should focus on competition objectives and leave other policy concerns to others, the importance of fundamental principles such as transparency, procedural fairness, and non-discrimination, consumer welfare as the objective of competition policy, and economics as the underpinning of competition analysis.