

ALERT



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China's New Antitrust Law Puts New Burdens on Companies Doing Business in China

With the world's attention on Beijing for the Olympic games, international companies also have a new reason to focus on China. China's new Anti-Monopoly Law (the "AML"), effective August 1, 2008, has the potential to have a substantial and broad-reaching impact on companies doing business in China or with Chinese companies.

Most international companies recognize the importance of taking proactive steps to comply with United States and European Union competition laws. International companies should also now invest appropriate resources to understand and comply with China's new competition law.

Like other comprehensive competition law regimes, the AML covers three principal topics: (i) anticompetitive agreements made between firms; (ii) abuse of dominant market position; and (iii) mergers or other transactions that may have the effect of eliminating or restricting competition. Similar to U.S. and EU laws, China's AML has significant implications for multinational companies, applying to any conduct that "has an effect of eliminating or restricting competition" in the Chinese domestic market. Thus, any company whose business touches China should take measures to ensure its business practices comply with the AML.

Time will tell whether China will vigorously enforce the AML and whether it will be enforced uniformly and fairly against all companies, regardless of origin. Many details of the AML have yet to be determined. There is evidence, however, that China is planning to expend significant resources to enforce the law.

Numerous government authorities will be involved in enforcing the AML, which should add to the complexity. An Anti-Monopoly Commission has been established by the State Council that will be responsible for "organizing, coordinating and guiding" the implementation and enforcement of the AML by the relevant government agencies. Reportedly the State Administration for Industry and Commerce (SAIC) will be responsible for monopoly agreements and abuse of dominant position (except where such behaviors involve pricing), the Ministry of Commerce will be responsible for review of mergers and other concentrations, and the National Development and Reform Commission will investigate anticompetitive pricing practices that are excluded from the SAIC's mandate.

The AML gives Chinese agencies broad enforcement authority, including the powers to investigate, to conduct on-site inspections, and to obtain relevant evidence, such as documents and records, electronic data, and emails. Notably, there is no requirement for a warrant or court order for search, seizure, or any other investigative action. Like most government investigations, antitrust

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investigations in China likely will be very costly and may involve significant attorneys' fees, downtime for employees and executives, and harm to a company's business reputation.

Non-compliance with the AML can potentially be costly. For violations involving monopoly agreements or abuse of dominant position, the authorities can confiscate any illegal gains and fine companies up to 10 percent of their total annual sales (it is unclear whether this is determined on the basis of China or worldwide sales). In addition to these penalties set forth in the AML, the law also provides for civil damages. For mergers, fines are capped at RMB 500,000 (approximately US \$73,000), but the authorities also can prevent, or order the reversal of, any transaction found to be improper.

Like U.S. and EU laws, China's AML provides incentives for companies that self-report violations of competition law. Chinese authorities may grant leniency, reducing or granting exemption from a penalty if a company reports anticompetitive agreements early and provides material evidence to the authorities. While the details of the leniency program have not yet been developed, the existence of the program heightens the need for clients to monitor their actions in China carefully and consult with counsel so as to make informed decisions about reporting any potentially illegal behavior.

Below are certain key provisions of the AML and some steps that can be taken to prepare for the implementation of China's new law.

1. Key provisions of the AML

The AML addresses three main substantive areas:

- (i) anticompetitive agreements made between firms;
- (ii) abuse of dominant market position; and
- (iii) mergers or other concentrations that may have the effect of eliminating or restricting competition.

While most of the AML's provisions are consistent with international norms and are based loosely on European, German, and U.S. competition laws, many questions remain about how the law will actually be implemented. The answers to these questions come from further implementing regulations or guidelines and actual enforcement experience.

(a) Anticompetitive agreements

The AML prohibits agreements, decisions or other concerted behavior that eliminates or restricts competition. The AML's

provisions relating to agreements between firms are roughly analogous to Article 81 of the EC Treaty and Section 1 of the Sherman Act. Like its European and U.S. counterparts, the AML distinguishes between "horizontal" agreements between competitors and "vertical" agreements between suppliers, distributors, and customers.

The AML provides a non-exhaustive list of prohibited "horizontal" agreements between competitors, including agreement between competitors that fix or change the price of products, limit production or sales volume of products, allocate sales markets or raw material purchasing markets, restrict the purchase of new technology or new equipment, restrict the development of new technology or new products, or jointly boycott certain transactions with customers or suppliers.

The AML also prohibits vertical agreements that fix the resale price or the minimum resale price. While earlier drafts of the AML prohibited resale price maintenance with no distinction between minimum and maximum resale prices, the final AML does not explicitly prohibit agreements to fix the maximum resale price. However, agreements fixing maximum resale price may infringe the AML if they can be characterized as anti-competitive under the AML's "catch-all" clause, which prohibits any agreements determined to be illegal by the enforcement authority.

The AML does provide exemptions for agreements with certain pro-competitive benefits, such as improving technology or research and development, enhancing product quality, reducing costs, improving efficiency, unifying product specifications or standards, enhancing the competitiveness of small and medium-sized business, or otherwise benefiting the public interest. To take advantage of the many exemptions, the AML requires proof that such agreements will not substantially restrict competition in the relevant market and that the agreements will actually benefit consumers.

(b) Abuse of dominant market position

Similar to EU competition law, China's AML prohibits a firm from abusing a dominant market position to eliminate or restrict competition.

Under the AML, a firm is dominant and subject to these provisions if it has the power to control price, output, or trade terms, or can affect market entry. Factors that may be used to establish dominant position are: the firm's market share; the ability of the firm to control the market; the firm's financial and technical capabilities; the extent of dependence on the firm by others; and barriers to entry. Importantly, a

dominant position can be presumed based on market share. A single firm is presumed dominant if it has a market share of at least 50 percent. Collective dominance is presumed when two firms have a combined market share of two thirds of the market, or three firms have a combined market share of three quarters of the market. When determining collective dominance, no firm with less than 10 percent market share will be presumed dominant.

The AML provides a non-exhaustive list of types of abusive conduct, which are prohibited if engaged in by a dominant firm without any reasonable justification, including “excessive” pricing, predatory pricing, tying, unreasonable trading conditions, refusals to deal, exclusive dealing, and price discrimination. The AML’s prohibition on abuse of dominant position also contains a “catch-all” clause, which prohibits any other behavior that the enforcement authority determines to be an abuse of a firm’s dominant position.

(c) Merger control

The AML also contains provisions relating to “concentrations,” which include mergers, acquiring control through share or asset acquisitions, or any other contractual acquisition of control. Transactions between a parent company and its subsidiaries or transactions among subsidiaries of the same parent company are exempt from review under the AML.

The merger control review provisions of the AML supersede the relevant provisions under the existing Chinese merger and acquisition regulations, which currently only apply to foreign companies and do not provide any specific penalties for non-compliance.

Effective August 3, 2008, the State Council of China’s Regulation on Notification of Concentration of Undertakings (the “Notification Rules”) provides implementation rules for merger control review. The AML requires pre-transaction notification of transactions that meet the thresholds set forth in the Notification Rules.

A transaction will need to be notified if either of the following thresholds¹ is exceeded:

- ♦ the parties’ aggregate **worldwide** sales in the prior accounting year exceed RMB 10 billion (approximately US\$1.5 billion) AND the individual sales in China in the prior accounting year of each of at least two of the parties exceeds RMB 400 million (approximately US\$59 million); OR
- ♦ the parties’ aggregate sales **in China** in the prior accounting year exceed RMB 2 billion (approximately

US\$294 million) AND the individual sales in China in the prior accounting year of each of at least two of the parties exceeds RMB 400 million (approximately US\$59 million).

Once a notification has been received, the competition authority will complete a preliminary review of the transaction within 30 calendar days. The transaction may proceed if the competition authority decides no further review is required or fails to make a decision within that initial review period. If, prior to the expiration of the initial review period, the authority notifies the parties that it will conduct further review, the authority then has 90 calendar days within which to complete the review. This review may be extended for up to 60 calendar days under certain circumstances such as the need for “further verification” due to inaccurate filing documents or a “significant change” to “relevant circumstances” after the initial notification.

A transaction cannot be consummated prior to receiving clearance from the relevant authorities. The competition authority may block, or approve subject to restrictive conditions, a transaction that is anticipated to eliminate or restrict competition. In order to determine whether a transaction will have an effect of eliminating or restricting competition, the AML will consider the market shares and market power of the parties, market concentration, anticipated effect on market entry, technological innovation, consumers and relevant suppliers, and the anticipated effect on national economic development.

2. Preparing for compliance with China’s Anti-Monopoly Law

Multinational companies with business in China should consider:

- ♦ Integrating the provisions of the AML into the company’s existing antitrust and competition compliance program and codes of conduct;
- ♦ Expanding existing training programs to include any executives or employees whose responsibilities include business in China; and
- ♦ Initiating a comprehensive review of contracts or agreements that may relate to China to ensure compliance with the AML.

Kirkland & Ellis LLP can assist your company in developing and implementing compliance programs relating to China, U.S. and EU antitrust and competition laws.

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- 1 The Notification Rules provide more simplified thresholds than those in the pre-existing Chinese merger and acquisition regulations, which provide that an antitrust filing is required if: (i) either party to the proposed merger or acquisition transaction has assets in China of over RMB 3 billion (approximately US\$441 million); (ii) the turnover generated by either party to the proposed merger or acquisition transaction in China in the current year is over RMB 1.5 billion (approximately US\$221 million); (iii) the market share of either party (to the proposed merger or acquisition transaction) and its affiliated entities in China reaches 20%, (iv) the market share of either party (to the proposed merger or transaction) and its affiliated entities in China reaches 25% following completion of the proposed transaction; or (v) the number of foreign-invested enterprises in the relevant Chinese industry directly or indirectly invested by either party to the proposed merger or acquisition transaction exceeds fifteen (15) following completion of the proposed transaction.
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