

AN OVERVIEW OF THE DRAFT CHINA ANTIMONOPOLY LAW

*H. Stephen Harris, Jr.**

Thanks to all of you for being here. I do not know how many of you are involved in business activities in China. The landscape is about to change or may be about to change. There is, for the first time in China's history, a draft antitrust law, and I have been lucky enough to be involved to a small extent in counseling with the Chinese Ministry of Commerce (MOFCOM) on behalf of the American Bar Association as well as being on the working group of the International Bar Association China Group to prepare comments and to attend conferences in Beijing and Washington, D.C. on the draft law.

I will tell you what I know, but it is all subject to change. As most of you know until fifteen or twenty years ago, only a few large jurisdictions had what we would call modern antitrust laws that were actually enforced. There were a number of old antitrust laws on the books. There has been a remarkably quick proliferation of antitrust laws driven by many considerations, some of them not entirely altruistic, including compliance with the requirements for membership in the World Trade Organization (WTO). To join the WTO, a member nation is to have competition laws meeting certain standards. China was an exception, and was allowed to accede to the WTO on, among others, the condition that they were going to adopt proper protections for competition later. This draft law constitutes the effort to meet that requirement, but also an effort by China to join all other major jurisdictions in adopting a modern antitrust law. Over eighty countries now also have merger review regulations.

* Mr. Harris, Jr. is a partner with the Atlanta law firm of Alston & Bird LLP. He serves as the Chair of the firm's Antitrust Practice Group and its Global Services Task Force. Mr. Harris is a member of the Council of the American Bar Association Section of Antitrust Law and the Editor-in-Chief of the two-volume treatise, *COMPETITION LAWS OUTSIDE THE UNITED STATES*, published by the ABA. These remarks were made as part of the Investment Panel at a conference entitled *U.S.-China Trade: Opportunities and Challenges*, hosted by the University of Georgia School of Law on April 14-15, 2005. These remarks have been edited by the speaker and Journal staff for content and length.

These are comparable to the U.S. Hart-Scott-Rodino Act with which you may be familiar. Now, in Zambia, if your merger acquisition affects the Zambian market sufficiently to trigger the thresholds under that jurisdiction's merger review law, you have to submit an antitrust filing there or risk fines, for example. Many of these laws in the smaller, less sophisticated countries present serious traps for unwary parties to mergers and acquisitions.

As you probably also know, the basic provisions for most antitrust laws around the world prohibit certain kinds of "concerted" conduct—that is, conduct by two or more parties, that are seen as being highly likely to harm competition. These laws prohibit such things as price fixing, bid rigging, conspiracies to restrict output, conspiracies to prohibit dealing with others, as well as allocations of customers and territories—"you take the territory west of the Mississippi; I'll take the territory east of the Mississippi." These kinds of joint conduct are commonly prohibited by most modern antitrust laws. In the United States, Section 1 of the Sherman Act prohibits such conduct. In the European Union, it is article 81 of the EC Treaty.

Most modern antitrust laws also prohibit certain types of conduct by competitors that have "market power," defined in the United States as the power to control prices or output, or that are "dominant," a non-U.S. concept defined in various ways, including through market share thresholds. These provisions apply to conduct of competitors even if they are acting alone—and thus are known as "unilateral conduct." In the United States, section 2 of the Sherman Act prohibits attempts to monopolize and actual monopolization through wrongful conduct. In the European Union, article 82 prohibits the "abuse of a dominant position." Other jurisdictions have various formulations of how to determine whether a party has sufficient power in the market that it should be subject to special rules of conduct that do not apply to weaker competitors that pose no threat to competition through their own unilateral conduct. In major jurisdictions with antitrust laws, achieving a monopoly by simply having a better mousetrap does not violate these rules governing unilateral conduct. A monopoly and the ability to charge money and monopoly rents is your reward for creating the better mousetrap, assuming you do not engage in unlawful anticompetitive acts to obtain the monopoly. And your monopoly profits are perhaps the most persuasive incentive for new entrants to try to enter the market by building an even better, or cheaper, mousetrap.

In addition to these common, core antitrust provisions prohibiting these familiar types of prohibited joint or unilateral conduct, the United States and other countries have unusual, and in some cases, unique provisions, such as the Robinson-Patman Act in the United States. As many of you know this is a

convoluted old law prohibiting price-discrimination, commercial bribery and other types of activities between sellers and buyers. Much of that law is considered bad economics by most modern industrial organization economists and bad law by many antitrust scholars and practitioners. It presents great difficulties in counseling clients, especially those involved in multinational or global sales and in fast-changing product markets. But old laws die hard. The Robinson-Patman Act is still on the books so companies have to try to reconcile its requirements with the realities of modern markets. And many others have unusual provisions as well, but the core aspects of a modern antitrust law are these issues.

China is the only major jurisdiction right now without an antitrust law. China has three things that are somewhat adjacent to an antitrust law. It has a price law, which will remind some of us old guys of Nixonian wage and price controls. This law empowers local government agencies to compel that specified products in a given region be sold at given prices. China also has provisional merger regulations for foreign investments, which are being enforced to a limited extent. Indeed, there are disagreements among various experts as to whether one currently has to file notifications under these provisional regulations and, if so, what kind of information one must file. Finally, there is an unfair competition law that prohibits trademark infringement and other kinds of unfair competition and deceptive trade practices. Some of its provisions are comparable to section 5 of the U.S. Federal Trade Commission Act.

Since about 1995, Chinese academics and officials have discussed a possible antimonopoly act—a modern, comprehensive, antitrust law for China. MOFCOM is a fairly new entity created by the merger of the former Ministry of Commerce and the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC). MOFCOM's Department of Treaty and Law has served as the principal source of talented experts who have served as the drafting team for the early versions of the proposed Chinese Antimonopoly Act. MOFCOM's responsibilities for the enforcement of foreign investment regulations, including the provisional merger regulations made it a repository of much learning and experience in competition issues.

As of the time of this conference, MOFCOM has made a draft publicly available. Further revised drafts are anticipated. The early draft has been met with a lot of criticism. It was revised in part to take into account criticism and comments from both within and outside China. The draft that is the subject of these remarks is the so-called "Submission Draft" that was submitted by MOFCOM in February 2004 to the Legislative Affairs Office of the State

Council. The submission of this draft is the next step in the Chinese legislative enactment process, indicating progress toward possible enactment of this law.

Many organizations and agencies have provided their comments to MOFCOM and also now to the State Council. We are told to expect a new draft soon. So again, everything I tell you may be wrong tomorrow. Some Chinese officials and experts have predicted enactment of the antimonopoly law in either late 2005 or late 2006, but there is a significant divergence of views over the likely timing of the passage. Regardless of the timing, however, most people that I have talked to who are involved in the process do believe that the enactment of the antimonopoly law, in some form, is likely to take place within the coming few years.

Serious concerns remain about certain provisions in the draft law, which center on three areas. First is the fear that the law could be used to target the activities of only (or predominantly) non-Chinese companies—that is, that the law may not be applied equally to Chinese companies and non-Chinese companies. Many commentators have emphasized that such discriminatory application of law would be inconsistent with the requirements of the WTO.

Second, there is a fear that the law could be used to invalidate intellectual property rights. That concern stems in part from comments we heard earlier in this symposium regarding the perceived weakness of China's enforcement of its intellectual property laws. Obviously, companies that deal primarily in intellectual property and whose value is tied up largely in intellectual property rights are among the loudest voices expressing concern that the new antitrust law may be used to further undermine intellectual property rights.

Finally, there is a vagueness and ambiguity in many of the draft law's provisions that simply leave companies and their counsel without guidance needed to assess their own conduct under the law. Companies seek my advice and the advice of many other lawyers asking how they can arrange their affairs to ensure that they will be in compliance on day one when this law is enacted. On many issues, the February 2004 Submission Draft is simply insufficiently clear to permit counsel to provide such important guidance. There are no guidelines, no regulations, and some of the provisions are extremely vague. Now, the United States has a very vague antitrust law called the Sherman Act, and we cannot be too critical. But the fact is that we have over one hundred years of case law, agency guidelines and scholarly analysis to help us better understand what it means and how courts will likely apply this law to given conduct. Even after more than a century of experience, though, there are areas of disagreement (including among courts) regarding the proper application of

the Sherman Act to some circumstances. That, in itself, is reason enough to hope for greater clarity in the Chinese law.

Our time is short and there is not sufficient time to discuss all the concerns that have been expressed about the Submission Draft. You might want to review the Official Comments of the American Bar Association Sections of Antitrust Law and International Law, which were submitted to MOFCOM and are available on the abanet.org website. However, to give you the highlights, I will quickly discuss a few of the provisions that present some of the most serious concerns.

Article I states that one purpose of the antimonopoly law is to protect social and public interests and promote the healthy development of a socialist market economy. The concern, of course, is that, in capitalist countries at least, the overarching purposes of antitrust law are consumer welfare and efficient allocation of resources. It is supposed to help ensure that the competitive process is allowed to work without interference except where a competitor engages in conduct that has the purpose or effect of damaging that competitive process. The law is supposed to permit that process to let the weaker, less efficient competitors lose and the more efficient companies win, ensuring lower prices, greater output, and innovation. There are fears that enacting an antitrust law that has, as one of its purposes, the protection of the healthy development of a socialist economy might be applied in a way that does not protect consumer welfare and efficiency. Some critics have expressed concern that this language may augur uses of the new law to protect inefficient domestic companies against efficient foreign companies, to the detriment of Chinese consumers. Indeed, some Chinese scholars have agreed with that concern and have recommended clarification of the extent to which this language could be used to undermine the pro-efficiency goals of antitrust law.

Article II of the Submission Draft provides that the antimonopoly law applies not only to conduct in China but also to conduct abroad that restricts or affects market competition in the territory of the People's Republic of China. This assertion of extraterritorial jurisdiction is broader than that asserted by the United States, the European Union, Canada, Australia or Japan under their respective antitrust laws. The United States, for example, requires a showing of a direct, foreseeable, and substantial effect on U.S. commerce before conduct that is outside the United States can be reached by U.S. law. Japan and the European Union have seen even that formulation as too broad. So, the language in article II of the draft has raised a lot of concern that the law may be applied to companies that have little or no activity in China, but the activities of which may have an indistinct or unforeseeable effect in China.

Article III prohibits monopolistic behaviors defined as “activities that, among other things, jeopardize social public interests.” Again, there is just no guidance there as to what that means, what kinds of interests are at stake, or how the enforcement agency might apply this provision. One of the examples in Article III of the type of monopolistic behavior that can violate the law is coordinated activities among business entities that will eliminate or restrict competition. Those of you who have studied economics and are familiar with oligopoly theory know that certain coordinated effects are expected when you have a small number of players in the market even if there is no collusion, no conspiracy. In the United States, absent an agreement, such normal activity of oligopolists does not violate the antitrust laws. Such “coordination” of prices or other competitive activities is perfectly lawful and accepted by economists as a normal consequence of the structure of markets with few sellers. As literally written, however, article III of the draft Chinese law prohibits such normal oligopolistic activity.

Article IV of the draft uses a term that translates directly as “given market,” but discusses only a geographic concept of the market. The draft does not address how to define a product market, which is of course necessary in order to determine whether conduct restricts competition, and to determine whether a competitor has market power and is therefore subject to the rules regarding unilateral conduct. Before an agency or court can assess the competitive effect of conduct by a luxury automobile manufacturer, it must know whether to include within the market all automobiles, only luxury automobiles, or perhaps all vehicles, including horse-drawn wagons. Courts and agencies must know whether they are to consider if consumers see these things as practical substitutes, whether an increase in the price of one product results in an increase in demand for another. Courts and agencies must also know how to assess such product market concepts in changing markets, such as today’s high technology markets. The entire concept of a product market definition is absent from the Submission Draft and is absolutely indispensable to the proper application of any antitrust law.

Article VI provides for the creation of a “competent agency” to enforce the antimonopoly law. This would be China’s first national antitrust enforcement agency. At this time, it is unclear if the antimonopoly agency would be housed in MOFCOM or the State Council, or some other agency, and there is wide disagreement among Chinese and non-Chinese as to which would be better. This is obviously an oversimplification, but I would say that MOFCOM is generally considered to have more expertise and experience, especially since they have dealt with foreign investment analysis and other kinds of economic

analysis in the enforcement of other laws, including anti-dumping law. But, many regard MOFCOM as being subject to more political pressure than is the State Council, because it is less autonomous. Conversely, the State Council is seen as more autonomous and therefore more immune from political pressure. But it is seen as having less expertise in terms of dealing with the kinds of economic issues and market analyses required in antitrust matters.

Chapter II of the draft antimonopoly law is comparable to section 1 of the U.S. Sherman Act or article 81 of the EC Treaty. It prohibits collusion, conspiracies, combinations, agreements in restraint of trade, bid rigging, price fixing, and other kinds of joint conduct accepted as being highly likely to injure the competitive process. But chapter II also contains a provision that prohibits other competitors from restricting “fair competition.” Fair competition was a buzz word in the early 1900s in the United States. Many states enacted now-repealed Fair Trade Acts, to protect small enterprises in America from larger enterprises, especially chain stores. So, especially in the United States, history makes antitrust practitioners and scholars wary of the term “fair competition.” I am not at all sure whether the drafters were aware of this connotation when they used the words that translate directly to “fair competition,” but that concern has been expressed.

Perhaps more substantively, there are serious misgivings about the extremely broad exemptions from the application of the Submission Draft’s anti-collusion provision. For example, the literal language of chapter II exempts members of horizontal price-fixing conspiracy from the prohibitions of the law if such price fixing is “beneficial to the development of the national economy and the social and public interest.” In all other modern antitrust jurisdictions, price-fixing would be considered, *ipso facto*, contrary to the public interest. And perhaps this is how the language of the Submission Draft would be interpreted, but the express language permits such an exemption. Likewise, the draft includes an exemption where parties engage in otherwise unlawful collusion in order to prevent significant decline of sales of obvious overproduction in order to adapt themselves to economic distress. That justification, I would submit to you, is the cry of all price fixers and certainly provides no basis for an exemption from price-fixing laws in other jurisdictions. Few believe that the drafters truly intended that this exemption will be used to protect such hard-core conduct. But, again, the language is there, presumably means something, and should be revised to ensure that no court or agency uses it to grant such a broad exemption. A few cynics fear that vague provisions such as this could be used by the Chinese enforcement agency or Chinese courts to apply the exemption to favored (perhaps domestic) entities

while denying the benefit of the exemption to others, rendering enforcement of the law selective and impossible to predict.

Chapter III of the Submission Draft is comparable to section 2 of the U.S. Sherman Act or article 82 of the EC Treaty. It is the anti-monopolization or anti-abuse-of-dominance provision. Again, this governs the single-firm conduct of entities with sufficient strength in the marketplace that certain kinds of conduct, taken alone, are likely to harm competition. The kinds of conduct that such powerful competitors can use to harm competition is limited only by the imagination, and statutes usually do not seek to define, except sometimes through non-exhaustive example, what specific kinds of unilateral conduct are subject to these laws. Monopolizing a market by burning down a competitor's plant was an example my antitrust professor used to illustrate the infinite variety of unilateral anticompetitive conduct—though, to be sure—that kind of conduct is usually prosecuted under arson statutes, not antitrust laws. One of the problems with the Chinese draft in this regard is that, in trying to accommodate the comments of experts, agencies and practitioners from the United States, the European Union and elsewhere, the drafters of the Chinese law have tried to borrow a bit from one jurisdiction and a bit from another. So the Submission Draft contains unilateral conduct concepts derived from article 82 and EC case law, as well as (not entirely compatible) concepts derived from U.S. law. There are provisions defining which parties are subject to this law by virtue of market share. Under U.S. law, conduct of competitors with huge market shares (indeed with a monopoly) may, at least in theory, not be subject to section 2 of the Sherman Act if those competitors, despite the size of their market shares, lack the power to control prices or output, because, for example, ease of entry by new competitors is easy and quick. Other provisions in chapter III seek to embody the kinds of economic analysis required under U.S. law before one is determined to have market power. However, the Chinese draft provides no guidance on how a court or agency is to reconcile these two concepts. Are the market share provisions merely presumptions that may be rebutted by a showing that other considerations such as the prospect of new entrants, in fact provides reasonable assurance that the firm cannot unilaterally injure competition? Absent clear language in the draft, a company cannot judge with any degree of certainty whether it may be subject to these prohibitions on unilateral conduct.

In addition, the presumptions of monopoly power or market dominance in articles 17 and 18 of chapter III of the Submission Draft are far lower than those in other jurisdictions around the world with laws that contain such presumptions. Though it seems unlikely that this outcome was intended, under

article 18, a business would be presumed to be dominant even if it has only 10% of the market if its largest competitor has 57% because as a result, the combined market share of the two would exceed two-thirds of the market. The thresholds in the current draft, applied in given cases, would clearly lead to the counterproductive consequence of constraining the competitive conduct of small firms and new entrants. In my view, if market share presumptions are to be included in the Chinese law, they must be much different from those in the current draft in order to comport with international norms.

Article 20 prohibits monopolistic high prices. There is no comparable provision in U.S. law. Again, economists would tell you that lawful monopoly prices are supposed to be high. That it is a good thing. Monopoly “rents,” as economists call them, are powerful incentives that draw in new competitors to sell at lower prices or to develop superior products. If not “monopolistic high prices,” what price is a monopolist to charge? How high is monopolistically high? This article is inconsistent with most economic thinking regarding the freedom of a lawful monopolist to charge what it can. It is also too vague to provide useful guidance to companies seeking to comply with its requirements.

Article 21 prohibits unfair low prices, which is also not seen in U.S. law. This provision may be even more troubling than the article 20 prohibition against high prices, because one of the principal goals of antitrust laws is consumer welfare and, in most circumstances, one of the clearest benefits to consumers from competition laws is lower prices. There is a similar low-pricing provision in the Japan antimonopoly law which I presume is the source, or a source, of article 21 in the Chinese draft. The Japanese unfair low-price provision has been used very rarely, but was in fact used recently in a Japan Fair Trade Commission investigation of Intel for allegedly charging low prices to computer makers in Japan. I worked on that matter so I have a point of view and am probably biased. But I do have to say that the notion that an agency is doing anything good for its country or its consumers by forcing a foreign producer to come in and raise its prices to the domestic producers is beyond me. There is significant concern on the part of many companies that this unfair low pricing provision in the Chinese law could be used to force foreign producers to charge supracompetitive prices for purposes unrelated to consumer welfare.

Chapter IV includes the premerger notification and approval provisions. I am not going to go through the details of these provisions, both because they are very involved and because they are, I believe, likely to change considerably before any of you needs to file a premerger notification in China under the new law. Suffice it to say that the chapter includes a discussion of what financial

information you have to give and how large a deal must be before filing is required. The chapter, however, does not define "control." Whether a merger, acquisition or other transaction transfers control from one competitor to another is central to most modern premerger notification regimes, simply because when control is transferred the two entities become a single competitive actor and the benefit of their separate competition is lost. When control is not transferred (and presuming the companies are competing lawfully), then a transaction does not present the kinds of competitive concerns normally deemed to require the expense and delay attendant to premerger notification and clearance. Properly defining control and determining when control has in fact been transferred has required careful drafting and fine-tuning in the United States, European Union and elsewhere, often in response to new M&A and joint venture structures dreamed up by clever corporate lawyers. But the laws of most jurisdictions with modern antitrust laws provide substantial, if imperfect, guidance to agencies and courts (and parties) in order to determine whether control is in fact being transferred and, therefore, whether a filing is required. So, the Chinese drafters need to develop a definition of control generally consistent with that of other jurisdictions, designed to subject to review only those transactions where the parties truly cease to be competitors.

Another clause provides that a merger application has to be denied if it will obstruct the development of a certain industry or regional economy. In addition to the vagueness of this provision, it presents a real concern about whether the new law might be used to protect a "local champion" in a given region from a more efficient foreign competitor, or even a more efficient competitor from another region of China.

Chapter VII sets out the provision for legal liabilities for violations of the new antimonopoly law. These include criminal penalties and fines. It is unclear from the Submission Draft whether the law is intended to confer a private right of action, in a people's court, for persons and entities injured by violations of the law. A leading commentator believes this is unlikely and that the remedy would be one through administrative proceedings before the antimonopoly agency.

Last, but not least, is article 66, the most controversial provision in the entire draft law. This provision has two sentences. The first sentence says that the antimonopoly law is not applicable to the exercise of legal rights under the patent law, the copyright law, or the trademark law. All owners of intellectual property agree generally with that statement. The second sentence of article 66, however, seems to take away what the first sentence gives. It says the law shall apply to conduct that *abuses* IP rights and violates the antimonopoly law.

No definition of “abuse” is provided. How article 66 will be applied raises real concerns for owners of intellectual property rights, especially high technology companies that rely upon the use of those rights to compete successfully. It is impossible to know how this provision may be enforced. Many commentators have expressed a concern that the provision could be used to compel licensing of intellectual property of larger competitors, especially foreign competitors.

In closing I would say that, in general, it is better to have an antitrust law than not to have one. And even a bad law provides some warning to competitors about the kind of conduct it must forgo. But a bad antitrust law can do much damage to competition, and one with many vague provisions fails even to give fair warning of competitors’ obligations. It is good to see that the drafters have put so much work into this Submission Draft and the drafting process itself has provided a welcome opportunity for the international competition community to confer with Chinese officials on the appropriate purposes, scope and implementation of a Chinese antitrust law. But the concerns that remain must be addressed in order to create a law that is consistent with international norms of competition law. In the next draft, we hope to see changes addressing the concerns that I just shared with you.

