

INTERNATIONAL COMPETITION LAW CONFERENCE

ANTITRUST DEVELOPMENTS IN JAPAN, CHINA AND KOREA

MONTREAL

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Introduction

Antitrust has come a long way in Asia. The year 2005 is likely to be one of the more significant years for the development of antitrust in Japan with the adoption into law by the Diet on April 20, 2005 of a bill containing very important amendments to the Anti-Monopoly Act (“AMA”). This is likely to mark the start of a new era in Japanese antitrust enforcement characterized by the introduction of a leniency program. In Korea, the government policy of promoting a free and fair market order has materialized in the form of tough action against cartels (36 cartels were identified and surcharges were imposed on 16 cases in the last year alone). In China, the draft Antimonopoly legislation has been submitted to the State Council for discussion and it is expected that it will be passed by the National People's Congress in 2006.

1. Antitrust developments in Japan

The AMA, which was enacted in 1947, rests on three basic pillars: the prohibition of private monopolization (the regulation of dominance and exclusionary practices); the prohibition of unreasonable restraint of trade (the regulation of anticompetitive agreements, including cartels); and the prohibition of unfair trade practices (“catch-all” prohibitions for anti-competitive practices not caught by the previous two prohibitions). In addition, the AMA contains provisions that regulate merger transactions that affect Japan.

Against this background, two significant antitrust developments have occurred recently in Japan. First, in the field of mergers, the Japan Fair Trade Commission (“JFTC”) abolished the guidelines that interpreted the substantive tests for review and replaced them with more thorough and modern guidelines that provide welcome clarifications and embrace a number of economic concepts. Second, the amendment to the AMA introduced significant changes to cartel regulation in Japan and antitrust enforcement policy there.

1.1 The new Merger Guidelines

Under Japanese merger control rules, the substantive test for clearance is whether the proposed merger, business transfer, corporate split, or share acquisition (in this section “M&A”) may result in a “substantial restraint of competition in a particular field of trade.”¹

On May 31, 2004, the JFTC published new merger guidelines on the application of the AMA to the review of business combinations (the “Merger Guidelines”), which replace the previous guidelines that interpreted the issue of whether “the effect [of a transaction] may be substantially to restrain competition in a particular field of trade.” The new Merger Guidelines build on previous guidelines, but are significantly more thorough and clearer while also relying more heavily than before on economic concepts. They clarify the category of business combinations whose impact on competition should be reviewed, and widen the scope of the existing exemption from merger control rules that apply to internal restructurings. Second, clearer detailed rules are provided for market definition (so-called “particular field of trade”). In particular, it is specified that both for product (or services) and geographic market definition, emphasis will be put on the substitutability of products (or services) from the perspective of users within the geographic boundaries of the territory of Japan. Third, the factors that will be taken into account when assessing whether a certain M&A transaction substantially restrains competition are explained in more detail and in a more structured way than previously. The substantive test is analyzed for each category of M&A transactions (horizontal, vertical and conglomerate). Another indication of the sophistication of the Merger Guidelines is that the JFTC will closely analyze market conditions both before and after the transaction to evaluate the actual impact of the transaction on competition by (among other things) analyzing whether it is likely that such transaction may facilitate cooperation between market players (actively or tacitly).

Perhaps the most interesting feature of the Merger Guidelines is the inclusion, as part of the analysis of the substantive test, of “safe harbors” for each of the three categories of M&A transactions identified above (specific harbors apply to each category). These are cases where the JFTC considers that there is no possibility that there may be a substantial restriction of competition or that such possibility is small. Each case is, however, reviewed on its own merits, and the application of the harbors (see below) needs to be analyzed carefully within the specific context of each transaction.

First, the Merger Guidelines identify two common “safe harbors” that apply to any type of horizontal M&A transaction. If either of these “safe harbors” is met (and there are no other competitive restrictions) the JFTC is likely to consider that the M&A transaction does not substantially restrain competition, namely:

- the merging parties’ combined market share is 10% or less; or
- the merging parties’ combined market share is 25% or less and the Herfindahl-Hirschman

¹ It is important to note that the JFTC can theoretically review any M&A transaction under the substantive test, regardless of whether or not the jurisdictional thresholds are met.

Index (“HHI”) is below 1,000.

If neither of the above “safe harbors” is met, the JFTC will proceed with the (separate) analysis of the non-coordinated (unilateral) and coordinated effects of the horizontal M&A transaction.

The Merger Guidelines also describe the following “safe harbors” for the non-coordinated (“unilateral”) effects of horizontal M&A transactions:

- the merging parties’ combined market share is 25% or less, there is one or more competitor(s) whose market share is not less than 10% and the HHI is less than 1800;
- the merging parties’ combined market share is 35% or less, there are at least two competitors with each a 10% or more share of the market and the HHI is below 1800;
- the degree of increase of the concerned parties’ group market share consists only of a small increase (HHI increase is below 100) and there is one or more competitor(s) whose market share is not less than 10%.

In addition, the following factors will be taken into account as part of the comprehensive examination of the non-coordinated effects of horizontal M&A transactions:

- status of the merging parties: market shares, market share ranks, pre-merger rivalries among the parties;
- the competitive pressures from non-merging firms: market shares, differences in market share between a merged firm and its competitors, excess capacity for supply, the degree of product differentiation;
- the potential and actual competitive pressures: import and entry, the presence of adjacent product and geographic markets, competitiveness in vertically related markets;
- efficiency and viability of merging parties.

Analysis of coordinated effects

Here, the aim of the JFTC is to identify M&A transactions where, due to the structure of the market, the parties to an M&A transaction may find it economically rational to coordinate their behavior and raise prices without entering into an agreement or other concerted practice that could be caught by the AMA’s prohibition of unreasonable restraint of trade (*i.e.*, of cartels and other collusive behavior among competitors). The specific factors that the JFTC will examine when undertaking its comprehensive examination of the coordinated effects of a horizontal M&A transaction are the following:

- The status of merging parties and competitors: the number of participants, similarity in product and cost structure, pre-merger rivalries among the merging parties, excess capacity for supply,
- The relevant market environment: transparency in business transactions, frequency and size of

orders, stability and maturity in demand, the speed of technological development, pre-merger competitiveness,

- The potential and actual competitive pressures: import and entry, the presence of adjacent products or adjacent geographic markets, competitiveness in vertically related markets,
- Efficiency and viability of merging parties.

Failing firm defense

Another welcome clarification in the Merger Guidelines is in regard to the JFTC's policy as to the failing state of an acquired firm as a defense to a horizontal M&A transaction. Again, this is not an entirely new policy, it is a clarification of the circumstances in which such a defense will be allowed. The (cumulative) requirements for the defense to be accepted are: (i) that the concerned parties' group market share in the relevant market(s) must not be more than 50%; (ii) that one of the concerned parties is a failing firm, or one party's concerned division is a failing division (and it is highly likely that the failing firm or division will otherwise exit the market); and (iii) that there is no other alternative that is less restrictive of competition than the proposed transaction with the other concerned party. If the above three requirements are met, it can be expected that the failing firm defense will operate as a kind of "safe harbor" for the companies that wish to combine their businesses.

As to vertical and conglomerate M&A transactions, the Merger Guidelines' general approach is to presume that such M&A transactions have less of an impact on competition than horizontal M&A transactions, since the number of competitors in the relevant market is not reduced as a result. Provided that a vertical or conglomerate M&A transaction does not result in vertical or horizontal market foreclosure, does not facilitate coordinated effects, and does not eliminate potential competition, it can be expected that such M&A transaction will not pose any significant competition issues.

The Merger Guidelines identify four "safe harbors" for vertical and conglomerate M&A transactions. If either of these "safe harbors" is met (and there are no other competitive restrictions) the JFTC is likely to consider that the M&A transaction does not substantially restrain competition:

- a merging parties' market share is 10% or less;
- a merging parties' market share is 25% or less and the HHI is less than 1000;
- a merging parties' market share is 25% or less, at least one competitor's market share is 10% or more, and the HHI is less than 1800;
- a merging parties' share is 35% or less, at least two competitors' market shares are 10% or more, and the HHI is less than 1800.

If neither of the above "safe harbors" is met, the JFTC will proceed with the (separate) analysis

of the non-coordinated (unilateral) and coordinated effects of a vertical or conglomerate M&A transaction in the same way as for horizontal M&A transactions.

1.2 Reform of the Anti-Monopoly Act

During 2003, a Study Group sponsored by the JFTC examined proposals for the reform of the Anti-Monopoly Act and put forward a bill which was adopted by the Japanese Diet on April 20, 2005 and which will become effective as of January 1, 2006.² The overriding intention of the reform is to toughen enforcement through increases in the rate of surcharges, broaden the scope of penalties and introduce a leniency system (closer perhaps to the EU model than to the US and Canadian plea-bargaining model).

Introduction of a leniency system

Leniency policy has rightly been termed as the greatest investigatory tool in the arsenal of any competition authority. By providing the opportunity for a cartel member to obtain complete immunity from fines or reductions in the amount of fines, the system destabilizes cartels by increasing the risk and fear of detection.³

The new Japanese leniency system provides for companies operating in Japan (up to three applicants per case) the opportunity to benefit from complete immunity or a reduction of the applicable administrative surcharge that would otherwise apply automatically upon a finding of infringement, in the following way:

- 1st applicant before initiation of JFTC investigation: 100% immunity
- 2nd applicant before initiation of JFTC investigation: 50% reduction
- 3rd applicant before initiation of JFTC investigation: 30% reduction
- leniency applicants applying after initiation of JFTC investigation: 30% reduction.

In conjunction with, or independent of, the above leniency regime, companies can benefit from a further 20% reduction from the normal fining level if they: (i) have voluntarily withdrawn from a cartel for over a month before the JFTC initiates its investigation, and; (ii) did not participate in the cartel in question for more than two years. There is no limit to the number of companies that can benefit from this "early withdrawal" reduction of the administrative fine.

² See JFTC press release at www2.jftc.go.jp/e-page/pressreleases/2005/April/050420.pdf.

³ See G. R. Spratling and D. J. Arp, The status of international cartel enforcement activity in the U.S. and around the world; 2005, paper presented at the IBA International Enforcement Conference, Tokyo, April 21, 2005.

Increase of administrative fines

The second pillar of the reform is the upward revision of the rate of administrative fines.⁴ The proposed fining level will be increased to 10% (4% for small companies) of the infringing company's revenue attributable to the relevant goods or services for the duration of the infringement, up from the existing 6% level for big companies and 3% for smaller companies. Importantly, an increased surcharge rate of 150% of the normal rate (*i.e.*, 15%) will be applied to companies that repeat a violation within 10 years of the initial finding. Additionally, the JFTC is currently studying closely the US and EU fining systems, with a view to assessing the merits of reforming the current surcharge system in Japan. This would be a welcome step, since the current and new system of capping administrative fines at a fixed level may be viewed as insufficient in deterring cartels when compared to the US, EU and Canadian situations where no such limitations on the upper limit of fines exist.

Procedural changes

In addition, at the procedural level, the JFTC will, as of January 1, 2006, obtain compulsory investigation tools and it plans to improve the rights of defense by providing respondents prior notice of its proposed order and the right to rebut it, including through the provision of evidence.

Leniency guidelines

Within the limited time remaining before the new rules come into play, the JFTC must produce guidelines explaining how the new rules will function. Areas of particular difficulty that will have to be addressed are:

- (i) the evidentiary standard that must be met by an applicant to benefit from immunity/leniency;
- (ii) conflicts of interest between employees and their employers that may arise from the JFTC's stated policy of guaranteeing no criminal penalties to employees of the first applicant only;⁵
- (iii) the issue of how to deal with the risk of discovery of leniency applications in the US, Canada and elsewhere while ensuring the most efficient co-operation with its US, EU and Canadian counterparts in the fight against international cartels;
- (iv) procedural issues such as the form of the application, timing considerations, use of "markers," etc.

⁴ These so-called "surcharges" are different from fines in that their application is automatic and their rate is also fixed by law so that the enforcing authority has no discretion to tailor the penalty to the facts of the case.

⁵ See Remarks made by A.Uesugi, Secretary General Japan Fair Trade Commission, at the IBA International Enforcement Conference, Tokyo, April 20-21, 2005.

Conclusions on recent antitrust developments in Japan

The JFTC's efforts aimed at increasing the effectiveness of the competition rules in Japan are starting to bear fruit.

First, in the field of merger review, the new guidelines will bring welcome clarifications and an alignment with internationally recognized merger control concepts based on sound economic principles. In particular, the adoption of “safe harbors” will make it easier for merging parties to assess the likely competitive analysis of a proposed transaction by the JFTC and therefore increase the predictability and transparency of merger control in Japan.

Second, the introduction of a leniency system in Japan is expected to have wide-ranging effects on the way companies go about their business in that jurisdiction but also elsewhere in the world. Given the importance of Japan as the traditional economic hub in Asia, it is highly likely that multinationals established there will see the risk of any cartel activity being detected increase exponentially with the introduction of a real economic incentive for cartel members to “blow the whistle” on other participants. Perhaps even more importantly for business managers, the JFTC's ability to request criminal penalties for individuals (including jail sentences) may focus their minds on the merits of co-operating with the JFTC. Enforcers have predicted that the introduction of a leniency system in Japan will bring a flurry of applications and hence uncover cartels that may have been going on for years, including those operating at the international level.⁶ It is submitted that the availability of leniency systems in the world's four major anti-trust jurisdictions will signal a new level of enforcement activity aimed at combating hardcore international cartels.

2. Antitrust developments in Korea

Korea's competition law evolution began in the early 1980's. Since that time, Korean competition laws have undergone almost constant evolution, including the most recent amendments which took effect in April 2005. The Monopoly Regulation and Fair Trade Act (the "MFTA") is the cornerstone of Korea's competition laws. The MFTA is administered by the Korean Fair Trade Commission (the "KFTC").

2.1 Conspiracy

Article 19 of the MFTA prohibits agreements among firms that "unfairly" restrict competition. Prohibited acts of collaboration include price fixing, market allocation, bid rigging, supply restrictions and generally "any practice that practically suppresses competition in a particular

⁶ S. D. Hammond, Director of Criminal Enforcement, Antitrust Division, US DOJ, Beating cartels at their own game – sharing information in the fight against cartels, Inaugural Symposium of the Competition Policy Research Center, Japan Fair Trade Commission, Tokyo, November 20, 2003.

business area by means of interfering with or restricting the activities or contents of business by other persons." The penalty for offending cartel activity is a fine of up to 10% of sales of the relevant product during the period of cartel activity or 2,000 million won.

Exemptions are available for agreements that are conducted for the purposes of any of the following:

- industry rationalization;
- research and technology development;
- overcoming economic depression
- industrial restructuring;
- rationalization of trade terms and conditions; or
- enhancement of competitiveness of small and medium sized enterprises.

Leniency

In 1997, Korea implemented a leniency program to promote the reporting of cartel activity. The leniency program underwent revision in 2002 and most recently in April 2005. The program currently provides for exemptions from prosecution or more favourable treatment ranging from a 30% reduction in fines to complete exemption and, since April 2005, permits Amnesty Plus where an applicant discloses evidence of a second cartel. Unlike the Amnesty and Immunity Programs in the United States and Canada, more than one party may be granted favourable treatment for the same conduct. Indeed, until changes to the leniency program were implemented in April 2005, the program permitted joint applications for and grants of leniency by participants in a cartel. Since April 2005, joint applications are no longer permitted but the first and second applicants will receive complete exemption and a 30% reduction in the surcharge, respectively. Although more than one party may be granted leniency, the threshold disclosure obligations to qualify for leniency are more strict than in the U.S. or Canada. In addition to ongoing cooperation obligations, leniency program applicants in Korea must first provide documentary or tape recorded evidence that can directly prove the conspiracy and the KFTC must not have knowledge or evidence of the cartel activity in question in order for leniency to be available.⁷

In April 2005, the Korean Government supplemented the leniency program with a reward system for informants (not participants) who provide supporting evidence of a violation.⁸

⁷ Article 22.2 Monopoly Regulation and Fair Trade Act of Korea and Article 35, Enforcement Decree for the Monopoly Regulation and Fair Trade Act. See also "Guidelines for Enforcing the Leniency Program for the Informant reporting the Improper Concerted Act", Korean Fair Trade Commission. Available online: <http://ftc.go.kr>

⁸ Korea Fair Trade Commission, press release dated April 14, 2005, "KFTC's Launch of Reward System for Information

2.2 Abuse of Dominant Position

The MFTA defines a dominant firm as a firm that can "determine, maintain, or change the prices, quantity or quality of commodities or services or other terms and conditions of business as a supplier or customer in a particular business area."⁹ The MFTA contains a market share test for dominance. Where a firm possesses a market share in excess of 50% or three enterprises possess a market share in excess of 75%, there is a presumption of dominance. In determining whether dominance is established, the MFTA permits consideration of barriers to entry, and the relative size of competitors.¹⁰ Dominant firms may not engage in "abusive acts", defined to include:

- unreasonably fixing, maintaining or changing the price of goods or services;
- unreasonably controlling the sale of goods or the performance of services;
- unreasonably interfering with the business activities of other enterprises;
- unreasonably hindering the entry of new competitors; or
- engaging in business transactions for the purpose of unreasonably excluding other competitors or engaging in acts that could harm consumers' interest.

Where it is determined that a dominant firm engaged in an abusive practice, the KFTC may order such a firm to reduce the price, cease and desist from the abusive practice, publish the fact that the law has been violated, and take other appropriate corrective measures. In addition, the KFTC may impose a fine of up to 200 million won, a civil monetary penalty up to 3% of the average annual sales for the last 3 consecutive business years, or may imprison officers and employees for up to 3 years.

2.3 Mergers

The acquiring party must notify the KFTC where transactions involve a corporation whose total amount of assets (including affiliates) or turnover is in excess of 100 billion won and the transaction involves any of the following: an acquisition of shares in another company; interlocking directorates (where the joint assets or turnover are in excess of 2 trillion won); mergers; acquisition or lease of all or a substantial part of the assets of a business; and subscribing to more than 20% of the shares of a new business.¹¹ Pre-notification is required where one or more of the parties to the transaction has assets or turnover in excess of 2 trillion won. There is a thirty day waiting period which may be extended by a maximum of sixty days. For all other transactions, the acquiring party must notify within 30 days of closing the transaction.

⁹ Article 2(7), MFTA

¹⁰ Article 2(7), MFTA

¹¹ Article 7, MFTA

In addition, the KFTC has mandated notification for overseas mergers and acquisitions where they may have anti-competitive effects on the Korean domestic market. Overseas M&A's must be notified to the KFTC if total worldwide assets or turnover of at least one of the merging parties are 100 billion won or more and the combined sales of the merging parties in Korea are 3 billion won or more.¹²

Transactions which result in a substantial restriction of competition will raise issues under the MFTA. A substantial restriction of competition will be presumed where the aggregate market share of the companies involved in a business combination:

- is in excess of 50%;
- is the largest in the business area concerned; and
- exceeds the market share of a company having the second-largest market share by 25% or more of the aggregate market share of the combined companies.¹³

The KFTC will consider enhanced efficiency where the merging parties can demonstrate that the efficiency effects "far exceed potential harms of curbing competition." In addition, the acquisition of a failing firm may rebut the presumption of anti-competitive effects.¹⁴

2.4 Private Claims

Anyone who has incurred damages as a result of a violation of the MFTA may claim compensation from damages pursuant to the MFTA, or pursuant to tort law under Korea's Civil Code. Until April 2005, plaintiffs had to wait for a final determination by the KFTC before filing a claim and had to be able to prove the precise amount of damages suffered as a result of the offending conduct. Changes implemented in April 2005 provide that plaintiffs may now bring suit prior to the KFTC's final determination. In addition, alleged violators now have the burden of proving the absence of intent or negligence. Of course, proving a negative will always be difficult.

3. Antitrust developments in China

The development of China's competition laws is relatively recent, and many would say incomplete. At present, the applicable laws are contained within several statutes, all promulgated since 1993, which grant authority to several different agencies for enforcement. With the intention of providing a more comprehensive regime, the latest draft of a proposed

¹² KFTC, "M&A Reporting Guidelines," Available online: <http://ftc.go.kr>

¹³ Article 7(4), MFTA

¹⁴ Article 7(2), MFTA

Antimonopoly Law was submitted to the National People's Congress in April 2005. It is anticipated that the Antimonopoly Law may come into force sometime in 2006.

3.1 Laws currently in effect

1993 Law Against Unfair Competition

The Law Against Unfair Competition (the "1993 Law") is the most significant legislation currently in force in China. It applies to any company operating in China and is directed towards protecting competitors, rather than competition. Unfair competition is defined to include "acts ...infringing upon the lawful rights and interests of another business operator and disturbing the socio-economic order."¹⁵ It proscribes the following conduct:

- Exclusive dealing by monopolists or public utilities (although monopoly is not defined)¹⁶;
- Tied selling (regardless of whether it is efficient or to the benefit of consumers) or the imposition of unreasonable conditions of sale (which are not defined)¹⁷;
- Bid rigging¹⁸;
- Predatory pricing or dumping - selling below cost¹⁹;
- False product representations and advertising²⁰.

The 1993 Law also applies to bribery, kickbacks, trademark infringement and theft of trade secrets.

The 1993 Law is administered by a variety of departments for industry and commerce above the county level.²¹ The administering agencies have the authority to order the cessation of the offending conduct and to impose fines between 10,000 and 200,000 yuan, depending upon the conduct and "in light of the circumstances." There is no separate adjudication by an independent tribunal or court, nor is there a right to appeal a decision of the authorities.

¹⁵Article 2, Law Against Unfair Competition, 1993

¹⁶ Article 6, Law Against Unfair Competition, 1993

¹⁷ Article 12, Law Against Unfair Competition, 1993

¹⁸ Article 15, Law Against Unfair Competition, 1993

¹⁹ Article 11, Law Against Unfair Competition, 1993

²⁰ Article 9, Law Against Unfair Competition, 1993

²¹ Article 3, Law Against Unfair Competition, 1993

In addition, a business operator who is affected by unfair competition under the 1993 Law may sue to recover the amount of their loss and the costs of the operator's investigation. Where the amount of the loss cannot be determined, the damages are prescribed as the profits derived during the period of the unfair conduct.

1997 Pricing Law

As with the 1993 Law, the Pricing Law aims to protect competing business operators, rather than competition in the market. In addition to setting out how government may control and guide prices, it proscribes the following conduct:

- Collaborating "to control market prices";
- Selling below cost;
- Misleading price claims;
- Price discrimination;
- Artificially increasing or decreasing supply to affect pricing²².

Similar to the 1993 Law, more than one agency can enforce the Pricing Law, including the county level, depending upon whether the conduct is national or regional in scope.²³ The relevant agencies may order cessation of the conduct, may confiscate "illegal proceeds" and may order fines that are up to five times the "illegal proceeds". Where there are no "illegal proceeds", they may be ordered to cease the conduct and pay a fine or, for serious cases, may have their business license revoked. Consumers may also seek damages for Pricing Law violations.

2003 Provisional Merger Rules

The Provisional Merger Rules (the "Rules") came into effect in April 2003. They purport to apply not only to foreign acquisitions of domestic companies, but also to offshore mergers which may have an effect on the Chinese domestic market. The focus of the Rules on foreign investors has been criticized as potentially being used to improperly exclude foreign competition.

The Rules are broad in potential scope. They are intended to ensure that mergers do not "result in excessive concentration and exclusion or restriction of competition and may not disturb the social or economic order or harm public interests."²⁴ The Rules mandate pre-closing notification to and review by two separate agencies, the Ministry of Commerce (MOFCOM) and the State Administration for Industry and Commerce (SAIC).

²² Article 14, 1997 Pricing Law

²³ Article 33, 1997 Pricing Law

²⁴ Article 3, Provisional Merger Rules

There are two separate sets of triggers, depending upon whether the transaction is an offshore transaction or an investment by a foreign investor in a domestic enterprise. Where a foreign investor is investing in a domestic enterprise, notification to and review by the Chinese authorities is required where:

- One party has more than 1.5 billion yuan in annual sales in China;
- The acquirer has merged or acquired more than 10 enterprises in related industries in China within one year;
- The market share of one party is greater than 20% (although it is unclear how market share is defined);
- The post-transaction market share will reach 25%;
- As otherwise required by MOFCOM/SAIC where those agencies believe the proposed transaction involves "huge market share" or may "significantly impact the market competition" or "state economy or safety".²⁵

For offshore mergers, the Rules specify the following triggers:

- One party owns assets worth more than 3 billion yuan in China;
- One party has more than 1.5 billion yuan in annual sales in China;
- The market share of one party is greater than 20% in China;
- The post-transaction market share in China will reach 25%;
- The acquiring party will have a post-transaction equity holding (either direct or indirect) in more than 15 domestic enterprises.

The offshore provisions, especially the capital ownership trigger, raises concerns for offshore worldwide mergers. The test could subject an offshore worldwide merger to Chinese review and approval where one of the parties has a substantial capital investment in China, without any additional effect of the transaction on the Chinese domestic market.

Discretionary exemptions may be available where the transaction would:

- improve market conditions for "fair" competition (although "fair" is not defined);
- lead to restructuring of a loss-making enterprise and continued employment;
- lead to the importation of advanced technologies and management skills; or
- improve the environment.²⁶

3.2 Antimonopoly Legislation not yet in force

China's Antimonopoly Law (the "Draft Law") has yet to be enacted but has gone through several unofficial drafts. What is expected to be the final draft (dated April 2005) was submitted to the State Council by the Ministry of Commerce. It is predicted that the Draft Law may be enacted

²⁵ Article 19, Provisional Merger Rules

²⁶ Article 22, Provisional Merger Rules

sometime in 2006.²⁷ The Draft Law would bring additional cohesion to competition laws in China and would consolidate administering authority.

The law applies to monopolistic conduct not only within China, but also to conduct outside China that "eliminates" or has a "restrictive effect on competition" in the domestic Chinese market.²⁸ There is no guidance on what the requisite "restrictive effect on competition" would be for the purposes of enforcement, i.e. there is no explicit requirement that there be a substantial anti-competitive effect. "Monopolistic conduct" is broadly defined to include conduct that eliminates or restricts competition, damages the "interests of consumers" or "endangers the public interest" including: agreements among enterprises; abuse of dominant market position; concentration that eliminates or restricts competition; and abuse of administrative power by government agencies that eliminates or restricts competition.²⁹ The broad concepts of damaging the interest of consumers and endangering the public interest have been criticized as injecting a degree of uncertainty with respect to circumstances in which the law will be applied.³⁰

Chapter 2 - Monopoly Agreements

The Draft Law prohibits all agreements and coordination among firms with the purpose or effect of eliminating or restricting competition, including: price fixing; supply restrictions; market allocation; joint boycotts; resale price maintenance; and bid rigging. The draft law does not limit its application to horizontal agreements in restraint of trade and could equally apply to vertical agreements, especially in the absence of a "substantial" lessening of competition requirement. Similar to rules in Europe, parties may apply to exempt specific arrangements where they:

- benefit consumers;
- do not eliminate competition within affected markets;
- improve product quality or technology;
- enhance efficiency, reduce cost, or develop new products or markets;
- respond to economic crises;
- boost the efficiency and competitiveness of small and medium-sized enterprises; or

²⁷ Nathan Bush, O'Melveny & Myers LLP, "Chinese Competition Policy: It takes more than a law" China Business Review online May-June 2005. Available online: www.chinabusinessreview.com/public/0505/bush.html.

²⁸ Article 2, Anti-Monopoly Law of the People's Republic of China (Draft dated April 8, 2005)

²⁹ Article 3, Anti-Monopoly Law of the People's Republic of China (Draft dated April 8, 2005)

³⁰ See for example "The Joint Submission of the American Bar Association's Sections on Antitrust Law Intellectual Property Law and Intellectual Law of the Proposed Anti-Monopoly Law of the People's Republic of China. Available online: www.abanet.org/antitrust

- promote national and public interests.

Potential penalties for those found to have entered monopoly agreements would include fines between 100,000 to 10,000,000 yuan or 10% of the turnover in the relevant market in the preceding year.

Chapter 3 - Abuse of dominant position

The Draft Law prohibits "abusive" practices by "dominant" firms, including shared monopolies. Dominance is defined as the power "to determine, maintain or alter price, quantity or other trading conditions so as to eliminate or restrict competition within relevant market". In determining whether a firm or group of firms is dominant, the Draft Law outlines a market share test: market share in excess of 50% for an individual firm, or a joint market share of more than 2/3. The finding of dominance based on market share is not rebuttable. Factors such as ease of entry, expansion of rivals and countervailing buyer power are not considered.

Listed abuses include: predatory pricing, price discrimination, refusal to deal, exclusive dealing, tied selling and denying access to essential facilities. With respect to predatory pricing, no applicable cost definition test is articulated and there is no requirement to demonstrate recoupment.

Potential penalties for those found to have entered monopoly agreements include fines between 100,000 to 10,000,000 yuan or 10% of the turnover in the relevant market in the preceding year.

Chapter 4 - Merger Review

The Draft Law tracks the US and EU procedures for assessing competitive effects. As with the transitional Rules currently in effect (discussed above), the Draft Law applies to both domestic and offshore transactions. Transactions that create or strengthen a dominant market position or eliminate or restrict competition will not be approved unless they benefit economic development and public interests.

Similar to the Rules, the Draft Law uses a market share trigger for determining whether notification is required and would require notification where one of the parties to an offshore transaction has significant capital in China. Pre-notification to the Anti-monopoly Authority is required where:

- the value of the transaction exceeds 300 million yuan and the aggregate worldwide assets or turnover in the preceding year is more than RMB 5 billion with at least one party's China-wide assets or turnover in the preceding year above RMB 3 billion
- The value of the transaction inside China is above RMB 500 million;
- the market share of either party to the transaction exceeds 20%;
- the transaction will lead to the market share of any party in China in excess of 25%

The Draft Law prescribes a longer waiting period than most other international authorities. The parties must wait a period of 45 days before closing. That period may be extended by an additional 90 days. In certain limited cases, the investigation may last 180 days.

Filing parties have an explicit right to be heard and decisions of the Authority must be made public. In addition, parties may apply for judicial review of the Anti-monopoly Authority's decision. The Authority may void the agreement, order divestiture, or impose fines between 100,000 to 10,000,000 yuan or 10% of the turnover in the relevant market in the preceding year.

Private Claims

The Draft Law permits persons injured by violations of the law to bring private actions in a Chinese court to recover up to double their compensatory damages or, where loss cannot be calculated, disgorgement of profits plus legal costs, but only where the authorities have confirmed a finding of monopolistic conduct.³¹

³¹ Article 52, Anti-Monopoly Law of the People's Republic of China (Draft dated April 8, 2005)