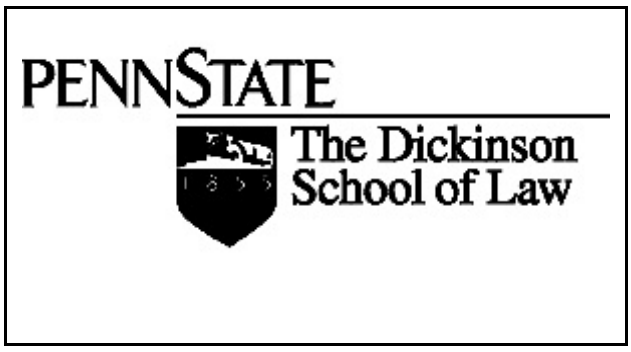

Before the House Committee on the Judiciary
Subcommittee on Courts and Competition Policy

Hearing on:

THE IMPACT OF CHINA'S ANTITRUST LAW AND OTHER COMPETITION POLICIES ON U.S. COMPANIES

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Chairman Johnson, Ranking Member Coble, and members of the Subcommittee on Courts and Competition Policy, I appreciate the invitation to discuss developments in the Chinese antitrust law and their effect on American businesses.

International competition law and enforcement raise serious policy issues, and Congressional attention is appropriately focused on these important questions. The Chinese Anti-Monopoly law is now nearly two years old, having gone into effect on August 1, 2008. In that short time, three separate agencies have been organized to enforce various aspects of the law, have issued many rules, regulations and procedures, and have begun to investigate and make rulings on individual cases. Importantly, a number of these decisions have involved American businesses operating in China.

I am a professor of law at Pennsylvania State University, Dickinson Law School, where I teach American and comparative antitrust law, among other subjects. My research and writing concerns competition law and policy, and I had the opportunity to teach and research the Chinese legal system on a Fulbright fellowship at the University of International Business and Economics (UIBE) in Beijing in the spring semester of 2008.

SUMMARY

In assessing the impact of the Chinese Anti-Monopoly Law, I would begin with the words of American Justice Oliver Wendell Holmes, writing in **The Common Law.** He explained that

> The life of the law has not been logic: it has been experience. The felt necessities of the time, the prevalent moral and political theories, intuitions of public policy ... have had a good deal more to do than the syllogism in determining the rules by which men should be governed. The law embodies the story of a nation's development through many centuries, and it cannot be dealt with as if it contained only the axioms and corollaries of a book of mathematics.[1]

The 'experience' of Chinese antitrust law encompasses the language of the statute, agency interpretations and decisions, and judicial rulings, all made against the backdrop of history. With this in mind, I would like to highlight the following key trends in the development and application of the law:

1. The Chinese Anti-Monopoly Law (the AML) concerns the same categories of business conduct as the American Sherman and Clayton Acts: horizontal cartels, anticompetitive mergers, monopolization and unreasonable restraints on distribution. Unlike the situation in the U.S., three government agencies are responsible for enforcing separate provisions of the AML. Also unlike American antitrust policy, the Chinese law explicitly incorporates other, non-competition factors into the analysis.

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[1]Oliver Wendell Holmes, Jr., **The Common Law** 1 - 2 (Boston: Little, Brown & Co. 1881).

2. American businesses are particularly affected by the Chinese merger control provisions because the law and its regulations require pre-merger notification based on the parties' total sales in China, not solely the nexus of the transaction to China. During the first year of the AML, more than 52 transactions were reviewed. One proposed merger was prohibited and five were approved with conditions. All of these transactions involved at least one foreign firm. The agency guidelines and language of the decisions employ mainstream analytic concepts but also may import non-economic factors such as "national economic development"[2] and "national security" in mergers involving foreign investors.[3]. Greater transparency in the analysis would facilitate business planning and international investment.

3. American antitrust law prohibits monopolization[4]. The AML prohibits abuse of dominant market positions and "monopoly agreements" (market power is not a prerequisite). These offenses may be defined so broadly in regulations that they limit the ability of firms to make independent decisions, for example choosing their business partners, under the first provision, or prohibit purely parallel behavior under the latter. The Abuse of Dominance regulations also appear to include a non-competition factor into the analysis, requiring consideration of the "impact of relevant actions on the economic operation efficiency, social public interests and economic development."[5 The Chinese agencies have not yet brought cases charging abuse of dominance and the private cases to date have not involved American firms. Further experience is needed to know whether the application of Chinese competition law in these areas is consistent with mainstream analysis.

4. Even after decades of liberalization and privatization, thousands of State Owned Enterprises (SOEs) may account for as much as half the economy.[6] These Chinese firms include traditional utilities as well as industrial sectors of the economy. Although SOEs meet the definition of "business operators" under the AML, they may be subject to different standards and sectoral regulations, even if they possess a dominant share of the market.

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[2]AML Art. 27(5).

[3]AML Art. 31.

[4]Unlawful monopolization requires more than merely a large share of a market. The elements of the offense are (1) monopoly power and (2) predatory or anticompetitive conduct. Sherman Act §1 also prohibits horizontal and vertical conspiracies and agreements in restraint of trade, but discussion of those agreements is beyond the scope of this statement

[5]Regulations on the Prohibition of the Abuse of Dominant Market Positions by Industrial & Commercial Administration Authorities (Draft for Comments) (May 25, 2010 (unofficial translation by Freshfields Bruckhaus Deringer LLP).

[6]See Joel R. Samuels, "Tain't What You Do": Effect of China's Proposed Anti-Monopoly Law on State Owned Enterprises, 26 Penn State Int'l L. Rev. 169 (2007).

5. In the field of intellectual property, dual policy concerns should be promoted. First, legitimate intellectual property rights (IPR) are entitled to protection against infringement. Second, the mere exercise of an IPR should not be deemed to be unlawful monopolization. The first concern is addressed under Chinese laws on patents, copyrights and trademarks and in international agreements which China has joined. Second, the AML, consistent with U.S. antitrust law, provides that exercising intellectual property rights is not prohibited, that is, patents, for example, are not unlawful abuses of dominance.

BACKGROUND AND STRUCTURE OF THE CHINESE COMPETITION LAW

Globally, competition laws have been developing at a rapid pace over the past several decades, supported by technical assistance and recommendations from a diverse collection of organizations including the OECD, the United Nations Conference on Trade and Development (UNCTAD) and the International Competition Network (ICN). China adopted the Anti-Monopoly Law (AML), its first comprehensive antitrust law of general application in 2007, and it became effective on August 1, 2008.[7]. It is part of important legal reforms that began as early as the "reform and opening up" of 1978, and implementation of the "socialist market economy" in 1992.[8].

Antitrust law comprises distinct types of trade restraints including horizontal agreements, both hard core cartels and other procompetitive price and non-price cooperation agreements; vertical price and non-price distribution restraints, including resale price maintenance and tying arrangements; monopolization; and mergers. Overall, the touchstone of antitrust law is the protection of consumer welfare and promotion of competition, but not special deference for particular competitors.

There is general consensus worldwide about many antitrust issues, but others are marked by divergent views in different jurisdictions. These differences may arise from unique national policies their antitrust laws are designed to promote. For example, there is widespread agreement that horizontal cartels are among the most harmful practices and should be prohibited. There is less agreement on the precise contours of where the outside boundaries lie, for example whether the appropriate enforcement mechanism should be limited to governmental actions or also provide private rights of action, and whether criminal or civil remedies are appropriate. There is less

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[7]Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Committee of the National People's Congress on Aug. 30, 2007, effective Aug. 1, 2008). The AML had been under development for more than a decade before it was adopted.

[8]Zhenguo Wu, Perspectives on the Chinese Anti-Monopoly Law, 75 Antitrust L.J. 73 (2008); Donald C. Clarke, China: Creating a Legal System for a Market Economy (prepared for the Asian Development Bank, Nov. 9, 2007). These articles provide a valuable description of the history and developments culminating in Chinese law reform, including adoption of the first antitrust law of general application.

consensus about some vertical restraints and distribution practices. Monopolization, or abuse of a dominant position, is another substantive area where there is general agreement about the competitive harm of monopolization but some divergence about other issues, i.e. whether and under what circumstances competition the law can deal with oligopolistic market structures and where, precisely, the boundary lies between vigorous competition and unlawful conduct.

Merger control laws fall in a different category of antitrust enforcement in several respects. Most significantly, modern merger statutes speak in predictive terms; mergers may be prohibited if they "tend substantially to restrict competition" in a properly defined relevant market and may be blocked before consummation. In a globalized world, many large transactions cross national borders and are thus subject to review by more than one national antitrust agency. Some acquisitions may involve key national industries or may tread upon national security interests or national champion firms. Finally, government enforcement agencies investigating proposed mergers do not have the luxury of lengthy investigations. Time is of the essence in a proposed merger and failure to prohibit a transaction before it is consummated makes any future challenge as difficult as unscrambling eggs. If countries operate on different timetables, require merging firms to produce very different information, or apply different substantive standards, then the ability to compete cross-border may be hampered.

It is unsurprising that global competition laws diverge in substance and process, analysis and fundamental approach to a greater or lesser degree. The AML follows approach of the majority of antitrust laws, dealing separately with agreements in restraint of trade, monopolization, and mergers. The prohibitions of anticompetitive agreements and monopolization borrow heavily from the language of Articles 101 and 102 of the European Union treaty, with important Chinese characteristics. There are special provisions covering State Owned Enterprises and Administrative Monopolies, both of which are especially relevant in the Chinese economy. Intellectual property rights are addressed specifically. The American standards on pre-merger notification and substantive analysis have been influential worldwide, and they are clearly the ancestor of the Chinese merger law.

However, AML Articles 1 and 4 diverge from the traditional model of antitrust analysis that is based solely on competition principles. These provisions suggest that interpretation and application of the Chinese antitrust law may differ in some important respects from American standards. Article 1 provides that "[t]his law is enacted for the purpose of preventing and curbing monopolistic conduct, protecting fair market conditions, enhancing economic efficiency, maintaining the consumer interests and the public interests, and promoting the healthy development of socialist market economy." Article 4 empowers the State to promulgate "and implement competition rules suitable for the socialist market economy, perfect the macro control, and improve a united, open, competitive and well-ordered market system."

Since 2008, three separate government agencies have been established and assigned responsibility for individual antitrust issues under the AML: the Ministry of Commerce, Anti-Monopoly Bureau (MOFCOM), the State Administration for Industry and Commerce (SAIC), and

the National Development and Reform Commission (NDRC). MOFCOM is responsible for reviewing proposed mergers, referred to as "concentrations" in the AML and enforcing the anti-merger articles of the law. SAIC has responsibility for enforcing the prohibitions against abuse of dominant positions, monopoly agreements and anti-administrative monopoly regulation. The NRDC is responsible for price agreements and has issued regulations on anti-pricing monopoly regulation. These categories are not airtight, so it is important that the regulations are consistent and applied transparently.

The agencies have been busy drafting and adopting rules and regulations, reviewing mergers, including transactions involving multinational firms, and rendering decisions in the nearly two years since the law became operational. Some of the proposed regulations have invited comments from interested parties, including the American legal experts testifying today, and the ABA Antitrust Law and International Law Sections and the American Chamber of Commerce - People's Republic of China (AmCham) have provided extensive analysis and recommendations that have been reflected in some revised regulations.

Most recently, SAIC disseminated three regulations on May 25, 2010, concerning monopoly agreements, abuse of a dominant market position and abuse of administrative powers. Comments were invited and provided by the ABA Sections of Antitrust Law and International Law, among other parties. These documents were revisions of earlier drafts and reflect some of the previous recommendations. On July 5, 2010, MOFCOM released a set of provisional rules concerning divestitures in merger cases, but did not seek comments at this stage. The openness of the Chinese enforcement agencies to considering views and recommendations of international competition experts is salutary. International benchmarking and promulgation of recommended practices have become features of effective antitrust enforcement in this era of global competition. Much of the networking now occurs in organizations such as the International Competition Network, but there is an important place for bilateral consultation and sharing of expertise among agencies and with non-governmental advisors. Future consultation on these and other draft regulations should be encouraged and should involve a variety of experts. Ultimately, clear rules based on sound economic principles will benefit the agencies enforcing the law, businesses seeking to comply, and the ultimate consumers. Beyond agency regulation, investigation and enforcement, Chinese courts have rendered a number of decisions in private actions under the dominance articles of the AML, none involving U.S. businesses.

In a 2010 Policy Brief, the OECD reported on positive economic developments and challenges China faces. The Report praises the growing competitive market economy, increased privatization, and new antitrust policy, stating that "market forces are now generally the main determinant of price formation and economic behaviour."[9]. It recommends lowering barriers to private competition and promoting foreign investment by limiting government intervention in

[9]OECD Policy Brief, Economic Survey of China, 2010 (Feb. 2010).

markets, including State Owned Enterprises.[10].

The trend towards a market economy in China carries the promise of continuing harmonization with modern antitrust analysis, but the AML's application of non-economic factors, undefined national security considerations in merger review, and potential special treatment of SOEs indicate that there may be some important divergences. American businesses operating in China are subject to the Chinese antitrust law for the "conduct of economic activities within the territory of the People's Republic of China" and for extraterritorial activities that have "the effect of eliminating or restricting competition on the domestic market of China."[11]. Indeed, American firms that meet the threshold turnover in China are subject to the mandatory pre-merger notification requirements for transactions that may, or may not, have a significant impact in China.

1. LEGAL STANDARDS INCLUDE NON-ECONOMIC FACTORS

The stated legislative purposes of the AML include traditional theories of consumer welfare, for example, protecting competition, enhancing efficiency and prohibiting monopolization. Article 1 of the law goes further, however, and also seeks to advance the "healthy development of [a] socialist market economy" and promote "public interests." These non-competition goals are not defined in the statute, but Article 4 empowers the State to "make and implement" regulations "suitable for the socialist market economy, [to] perfect the macro control, and improve a united, open, competitive and well-ordered market system."

The SAIC Regulations on the Prohibition of the Abuse of Dominant market Positions (draft for comments, May 25, 2010), article 8, may have incorporated one such non-economic consideration into the list of justifications for firms charged with abusing a dominant market position. These listed factors include competitive effects and business justifications (both traditional economic considerations) but also the effect on "social public interests and economic development."[12] This provision is in accord with the AML legislative purposes, but is not generally within the mainstream of modern antitrust analysis.

2. MERGER REGULATIONS AND DECISIONS

Even before the Anti-Monopoly Law, MOFCOM promulgated guidelines for foreign acquisitions of Chinese firms. The Provisions on Acquisition of Domestic Enterprises by Foreign Investors law (Foreign M&A Rules) provide that "when a foreign investor acquires a domestic enterprise, it shall abide by Chinese laws ... and adhere to the principles of fairness, reasonableness, compensation of equal value and good faith. It shall not ... disturb the socio-economic order, damage

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[10] Id.

[11] AML Art. 2.

[12] Regulations on the Prohibition of the Abuse of Dominant Market Positions by Industrial & Commercial Administration Authorities (Draft for Comments) (May 25, 2010)(translation by Freshfields Bruckhaus Deringer).

the public interest ..." Article 12 requires "parties involved in acquisitions of domestic firms by foreign investors" to obtain approval if the "acquisition involves in any major industry, or has or may have an impact on the state economy security, or may result in transfer of the actual controlling right of the domestic enterprise owning any famous trademarks or traditional Chinese brands." Approval is also required if the transaction "involves in any major industry, or has or may have an impact on the state economy security, or may result in transfer of the actual controlling right of the domestic enterprise owning any famous trademarks or traditional Chinese brands." This concept was transplanted, in part, to AML Article 31, which provides for additional review of transactions between foreign buyers and domestic firms and "national security" is implicated. That term is undefined in the AML and has not yet been explicated in regulations, so the breadth of the concept is unclear. Does it include economic interests of the state or solely national defense? As discussed above, the potential consideration of non-economic factors could inhibit competition and decrease consumer welfare, a result antithetical to the generally-recognized goals of antitrust.

Since 2008, MOFCOM has supplemented the Anti-Monopoly Law with a series of regulations that set monetary thresholds for pre-merger notification, describe the filing requirements in more detail, define relevant markets and establish standards for investigations of transactions below the filing thresholds or are otherwise not notified. These regulations were first produced in draft form and, in accord with the best practices recommended above, comments were solicited and provided by a number of sources including American antitrust experts.

Adding to the body of regulatory law, MOFCOM distributed new rules on divestiture standards and procedures on July 5, 2010. These regulations are concrete and practical, applying to any divestiture of assets required by the agency or agreed by the parties as a condition for approval of the proposed merger. Generally, the parties are required to maintain any such assets, operate them independently, and provide information and assistance to prospective buyers. The rules require appointment of a trustee to monitor the entire process and, if the parties cannot find an appropriate buyer, require another trustee to do so. There was no opportunity to comment on the specifics of the regulation, but preservation of assets and efficient divestiture practices appear sound and within the mainstream of antitrust practice.

The reputation of merger enforcement will depend on transparent analysis based on sound principals and equitable treatment of all proposed transactions, whether they involve foreign or domestic firms. This process has the additional effect of protecting the competitive process rather than individual firms and ultimately benefits consumers by offering them more choice in the competitive market. As Justice Holmes observed, the life of the Chinese anti-merger law, supplemented by its rules and regulations, is revealed most clearly by experience in the cases. Current official statistics are unavailable, but it is reported that MOFCOM reviewed 52 proposed transactions during the first year of the AML (August 2008 to July 2009) and approved 46 of them without conditions.[13]. One transaction was prohibited and five were approved with conditions.

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[13]Mayer-Brown JSM, China's Anti-Monopoly Law Merger Control Regime - 10 Key Questions Answered (Part 1) (March 2, 2010). Assuming a fairly constant stream of transactions, it is

The prohibited transaction, Coca-Cola/Huiyuan, involved a foreign buyer seeking to acquire a well-known domestic firm. The five transactions approved with conditions all involved foreign firms and, according to the same source, no transaction involving two domestic firms was rejected outright or approved subject to conditions.[14]. A recent briefing paper commented that the AML merger articles generally do not reflect "inherent bias" against non-domestic firms, while expressing concern about Article 31 and the specific transaction discussed below.[15].

The prohibited merger of Coca Cola / China Huiyuan Juice Group is an early but instructive example of the merger control process. Huiyuan, the Chinese target firm, was founded in 1992, in Shandong Province and, by the date of the proposed transaction, had a national distribution network. It was the largest privately owned juice-producer in China, selling juice, water, tea, dairy and nectar drinks. The acquirer, Coca Cola had marketed carbonated soft drinks in China since 1976, and Minute Maid juice since 2007. The proposed transaction was a $2.4 billion all cash offer, made in 2008. The reaction of Chinese netizens to the proposed acquisition was strongly negative. A Sina.com poll found that 80% of 229,000 responders voted against the proposed merger because foreign firms should not take over Chinese "pillar brands."

The first step in merger analysis, both in the United States and under the AML, is a determination of the product and geographic markets. The firms had less than 10% of a hypothetical market that included "all beverages." Huiyuan was the largest juice firm in China, with under 46% of the 100% pure juice market. If the merger had been approved, the merged firm would have possessed approximately 37% of a market defined as "juice drinks," but only 18% of a market defined as "carbonated soft drinks." Coke itself had 16.3% of "carbonated soft drink" market pre-merger, less than the 17.9% market share of the largest firm in the market, Groupe Danone.

The parties to the transaction notified MOFCOM under the pre-merger notification requirement and the review proceeded through a second stage review, which stated that the investigation was proceeding under AML and not the foreign M&A law. On April 18, 2009, MOFCOM prohibited the transaction and published a brief analysis finding that there was a threat to competition, which was not offset by any justification in the AML. The decision does not provide a detailed economic analysis of the product market, defined as "fruit juice." The threatened anticompetitive harm, according to the decision, was Coke's power to use its dominance in the carbonated soda market to limit competition in the juice market, resulting in higher prices and fewer

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possible that MOFCOM has reviewed nearly twice that number at the 2-year anniversary of the law.

[14]Id. The conditional approvals were InBev/Anheuser Busch, Mitsubishi Rayon/Lucite, Pfizer/Wyeth, GM/Delphi, and Sanyo/Panasonic.

[15]Id. The paper expresses concern but does not contend that the process is permanently flawed and recommends careful compliance with the merger regulations and cultivation of good relationships.

choices for consumers, a monopoly leveraging theory. In an official statement, the agency stated: "If the acquisition went into effect, Coca-Cola was very likely to reach a dominant position in the domestic market and consumers may have had to accept a higher price fixed by the company as they would not have much choice." Additionally, the decision found that power of the brands in the transaction would raise barriers to entry and threaten small and medium juice firms. The Foreign Ministry rejected concerns that the decision was based on national protectionism. The case raises several issues not yet clearly answered under the AML and the merger regulations: did the transaction implicate national security? Does acquisition of a famous domestic brand threaten economic security?

3. ABUSE OF DOMINANT MARKET POSITION/MONOPOLIZATION

In the first two years of the AML, standards of the offense of abuse of dominance have been developed through SAIC rules and private enforcement actions. There have been a number of private actions, but no reported dominance cases involving U.S. firms. The important policy considerations in the monopolization cases are both procedural and substantive.

Abuse of dominance cases are complex, requiring the decision-maker to apply sophisticated economic analysis to distinguish between lawful competition and unlawful predation. The SAIC itself is responsible for investigation and enforcement in cases alleging abuse of dominance or monopoly agreement. It has broad authority to decide whether or not to initiate and decide a case at the SAIC level, or, where appropriate, to delegate the matter to one of the provincial, autonomous regional or municipal agencies[16]. The need for judicial expertise is also appreciated and cases are likely to be directed to the Intellectual Property sections of lower courts or to the Intermediate Courts because of their experience in handling complex cases. This is a positive development that should give litigants' confidence in the quality and efficiency of the decisions.

4. STATE OWNED INDUSTRIES, ADMINISTRATIVE MONOPOLIES

AML Article 7 provides that "With respect to the industries controlled by the State-owned economy and concerning the lifeline of national economy and national security ... the State shall protect the lawful business operations ... and shall supervise and control the business operations of and the prices of commodities and services ... to protect the consumer interests and facilitate technological progress." Further, it requires SOEs to "be honest, faithful and strictly self-disciplined, and accept public supervision, and shall not harm the consumer interest by taking advantage of their controlling or exclusive dealing position."

Articles 32 - 37 prohibit the abuse of administrative power. These strong provisions prohibit public agencies from abusing their power to limit competition or benefit particular firms, prohibit discrimination among national regions, and prohibit special consideration for local firms in public

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[16] Procedural Rules by Administration of Industry and Commerce Regarding Investigation and Handling of Cases relating to Monopoly Agreement and Abuse of Dominant Market Position (unofficial translation by Jones Day) (2009)(referred to as Administration of Industry and Commerce (AIC) authorities).

purchasing and bidding. These sections, as supported by the July 2010 SAIC regulations, are not typically found in antitrust laws, but they are appropriate and pro-competitive in the highly regulated Chinese context. If enforced, these sections are both pro-consumer, because they promote competition, and pro-private enterprise, including American businesses that wish to operate in China.

5. INTELLECTUAL PROPERTY

AML Article 55 provides that the mere exercise of intellectual property rights is not prohibited and is not a violation of the antitrust law, but "abuse" of intellectual property rights that restrains competition does violate the statute.[17]. This provision has the potential to advance the dual considerations important to intellectual property: legal protection of IP as property rights and recognition that the intellectual property, even including patents, does not necessarily give the owner the kind of "power" prohibited by the abuse of dominance provisions.[18].

While a detailed discussion of the Chinese laws and international agreements protecting intellectual property rights is beyond the scope of this comment, the legal infrastructure, including creation of special IP courts, is in development.[19].

CONCLUSIONS

Chinese antitrust law, interpretation and enforcement have undergone significant reform in the two years since the AML came into effect. The organization and staffing of the enforcement agencies and the publication of numerous procedures, guidelines and regulations suggest that capacity building is important and ongoing. The Holmesian 'life' of this law shows consideration of international best practices and a trend towards the consumer welfare model of antitrust thought, mediated by domestic approaches to national policy and governance. Finally, the AML and regulations include certain non-economic considerations and other provisions, such as treatment of SOEs and administrative monopolies, that are specific to the national history and development of the Chinese market economy.

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[17]AML Art. 55.

[18]This is in accord with the recent Supreme Court decision in Illinois Tool Works, Inc. v. Independent. Ink, Inc., 129 U.S. 1109 (2006). Although the case concerned a tying arrangement and not a monopoly, the issue was whether market power should be presumed when a product is patented. The Court rejected the presumption of power and held that proof of power was required.

[19]For brief summaries, see Kristina Sepetys and Alan Cox, Intellectual Property Rights Protection in China: Trends in Litigation and Economic Damages, (NERA 2009), Righard S. Gruner, Intellectual Property in the Four Chinas, 37 Int'l Law News (ABA Section of Int'l Law, Spring 2008).