# SECTION 2: FOREIGN INVESTMENT CLIMATE IN CHINA

## Introduction

In addition to China's economic slowdown, foreign companies doing business in China continue to face challenges related to China's preferential treatment of domestic firms, including foreign investment restrictions, unequal and sometimes targeted law enforcement and implementation, weak enforcement of intellectual property (IP) rights, and lack of transparency. To explore these issues, the Commission held a hearing in January 2015 on the foreign investment climate in China, China's Anti-Monopoly Law (AML) enforcement, and continuing reform of the foreign investment framework. This section draws on expert testimony, findings from the Commission's July trip to China, and a substantial body of staff research into China's application and enforcement of the AML and other investment-related laws.

## Trends in U.S. Direct Investment in China

Bilateral foreign direct investment (FDI) between the United States and China remains relatively low, considering the two countries have been the top recipients of global FDI since 2009 and are among the top ten largest sources of annual outbound FDI in the last decade.[1] For the first time, Chinese FDI flows to the United States now exceed U.S. FDI flows to China by most measures due to rapid growth in Chinese annual FDI to the United States over the past five years, according to U.S.-based advisory firm Rhodium Group.[*][2] In contrast, growth in U.S. FDI in China over the last five years appears to have slowed and even decreased. According to the U.S. Bureau of Economic Analysis (BEA), in 2014, annual U.S. FDI in China reached $6.3 billion—a 4.9 percent decrease year-on-year—bringing the share of U.S. FDI flowing to China in 2014 to 2 percent of total outbound U.S. FDI.[3] As seen in Figure 1, official U.S. data show accumulated U.S. FDI into China measured $65.76 billion in 2014, representing approximately 9 percent of the stock of U.S. direct investment in the Asia Pacific region and only 1.3 percent of the total stock of U.S. investment abroad.[4] China's Ministry of Commerce (MOFCOM) estimates the U.S. FDI stock in China is higher—reaching around $70 billion in 2012—illuminating discrepancies in official data, which are lagging significantly and often fail to capture major trends.†

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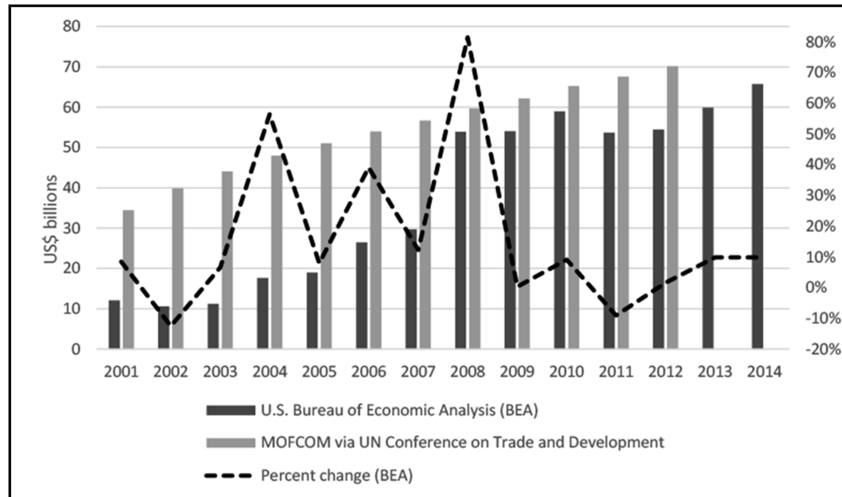
* For a more detailed analysis of U.S.-China bilateral investment, see Chapter 1, Section 1, "Year in Review: Economics and Trade," of this Report.

† International Trade Administration, *Report: Foreign Direct Investment (FDI) in the United States from China and Hong Kong SAR*, July 17, 2013; Thilo Hanemann, "China Investment Monitor: Methodology Update," *Rhodium Group*, July 15, 2015.

**Figure 1: U.S. FDI Stock in China, 2001–2014**
(cumulative, historical-cost basis)




*Note:* Latest data available (as of August 2015).
*Source:* U.S. Department of Commerce, Bureau of Economic Analysis; China's Ministry of Commerce via UNCTADstat database.

Across industries, official U.S. data show the top destination by far for U.S. direct investment into China is manufacturing (52.5 percent), followed by wholesale trade (8.8 percent), depository institutions (6.1 percent), nonbank holding companies (5.3 percent), and finance and insurance excluding depository institutions (5.2 percent) (see Table 1).[5] U.S. investment in manufacturing in China fell into several main categories, including chemicals, transportation equipment, computers and electronic products, and food (see Figure 2). As seen in Table 1, the overall sectoral distribution of investment has for the most part remained constant since 2007; data for intervening years were not comprehensive.

**Table 1: U.S. FDI Stock in China by Sector**
(US$ millions)

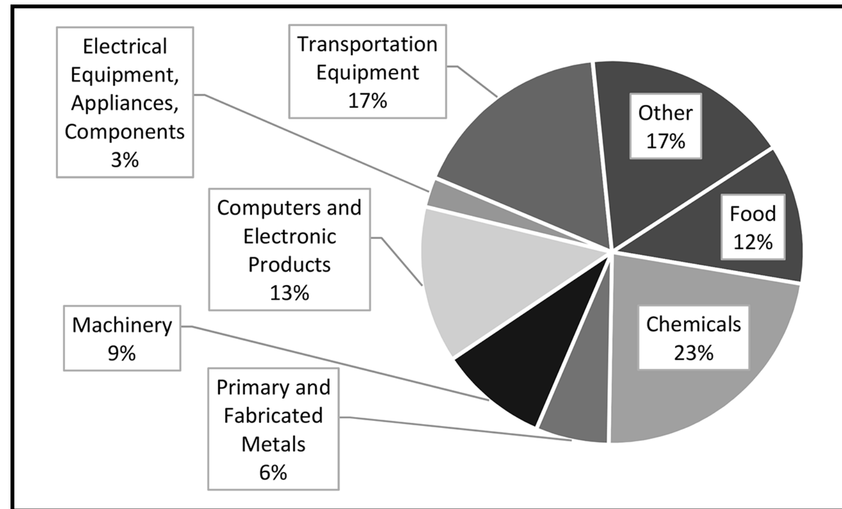
| | 2007 | 2009 | 2014 |
|---|---|---|---|
| **Mining** | 1,772 | 3,148 | 3,323 |
| **Manufacturing** | 18,461 | 23,972 | 34,552 |
| **Wholesale Trade** | 2,015 | 2,645 | 5,834 |
| **Information** | 546 | 2,487 | 1,792 |
| **Depository Institutions** | 850 | (D) | 4,045 |
| **Finance** | 1,798 | (D) | 3,417 |
| **Professional, Scientific, and Technical Services** | 227 | 777 | 1,732 |

**Table 1: U.S. FDI Stock in China by Sector—*Continued***
(US$ millions)

| | 2007 | 2009 | 2014 |
|---|---|---|---|
| **Nonbank Holding Companies** | 1,644 | (D) | 3,494 |
| **Other** | 2,397 | (D) | 7,577 |

*Note:* (D) indicates that the data in the cell have been suppressed to avoid disclosure of data of individual companies.
*Source:* U.S. Department of Commerce, Bureau of Economic Analysis.

**Figure 2: Total U.S. FDI in China's Manufacturing Sector by Product, 2014**




*Note:* For U.S. FDI, industry classifications for estimates after 1997 are based on the North American Industry Classification System (NAICS).
*Source:* U.S. Department of Commerce, Bureau of Economic Analysis, *China Factsheet*, July 31, 2015.

## China's Foreign Investment Regime

### *Legal and Regulatory Framework*

Compared to other large economies, China maintains a restrictive FDI regime. China's discriminatory restrictions on foreign equity and onerous screening and approval requirements have placed it at the top of the Organization for Economic Co-Operation and Development's (OECD) FDI Regulatory Restrictiveness Index* every year since its inception in 2010.[6] The U.S. Department of State estimates that in addition to over 1,000 rules and regulatory documents related to FDI in China issued by central government

* Among OECD economies and non-OECD member economies. The OECD FDI Regulatory Restrictiveness Index is based on four main indicators: "equity restrictions, screening and approval requirements, restrictions on foreign key personnel, and other operational restrictions (such as limits on purchase of land or on repatriation of profits and capital). The discriminatory nature of measures is the central criterion to decide whether a measure should be scored." Blanka Kalinova, Angel Palerm, and Stephen Thomsen, "OECD's FDI Restrictiveness Index: 2010 Update," *OECD Working Papers on International Investment* 03 (2010): 6.

ministries, local legislatures and governments also enact their own rules and regulations on foreign investments in their jurisdictions.[7] Taken together, these laws and policies—and the uncertain application thereof—create a complicated, opaque, and unfavorable environment for foreign investment.

In an effort to push through a series of open market reforms announced during the November 2013 Third Plenum, China's MOFCOM and the National Development and Reform Commission (NDRC) published a draft of a new, unified foreign investment law (FIL) on January 19, 2015.[8] When it comes into effect, this new law will apply to all forms of foreign investment and replace the three existing laws, potentially streamlining and clarifying foreign investment procedures.* (For details on the draft FIL, see "Reforms of China's Foreign Investment Framework" in this section.) Until the unified FIL is implemented, FDI in China will continue to be governed by three main laws: the Sino-Foreign Equity Joint Venture (JV) Law, the Sino-Foreign Cooperative JV Law, and the Wholly Foreign-Owned Enterprise Law. In addition to the these laws, the Chinese government maintains a series of policies that directly and indirectly affect foreign investors and the overall foreign investment climate in China, including additional government approval policies, industrial policies, and processes for reviewing and appealing administrative decisions.

*Foreign Investment Approval Policies*

Before a foreign-invested entity (FIE) is established in China, it must undergo a lengthy approval process. Under the authority of China's State Council, MOFCOM and the NDRC maintain the Catalogue for the Guidance of Foreign Investment Industries (Catalogue), which categorizes industries as either "encouraged," "restricted," or "prohibited" to foreign investment.† [9] In principle, any sector not included in the Catalogue is permitted, and foreign investors in such sectors need only file with the local government. In encouraged industries, foreign investors may enjoy preferential policies such as tax incentives. In restricted industries, however, foreign investment is often subject to higher levels of government scrutiny, stricter review, and burdensome application requirements.[10] The Catalogue also outlines other structural guidelines for foreign investment in specific sectors. For example, in certain industries, foreign investment may be limited to Sino-foreign JVs, or may require that a Chinese partner is the "controlling shareholder" of the investment.[11]

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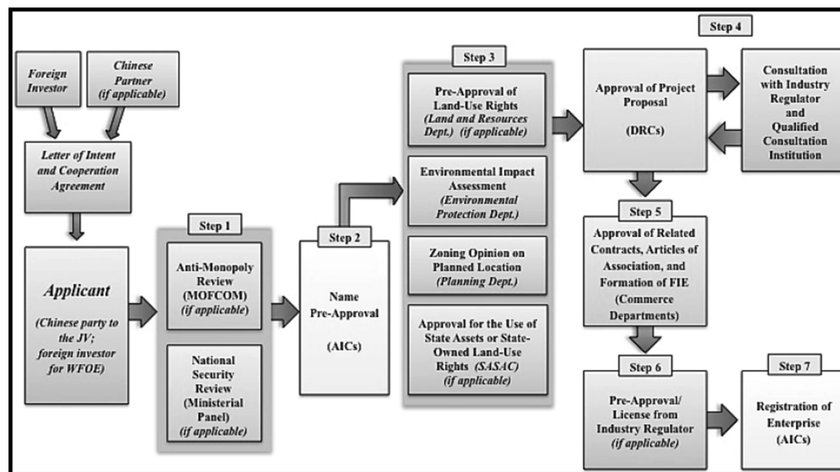
* MOFCOM will revise the draft FIL on the basis of comments gathered from the public, and submit the revised draft to the standing meeting of the State Council for deliberation and then circulate an updated draft for the Standing Committee of the National People's Congress to review. The FIL is not expected to be promulgated before 2018. Anna Elshafei, "China's Draft Foreign Investment Law Could Be a Game Changer?" *Miller Canfield*, June 8, 2015.

† "Encouraged" sectors include high technology, green technology, energy conservation, and pollution control; "restricted" sectors include rare earth smelting and passenger rail transportation companies; "prohibited" sectors include those that fall under national security (such as manufacturing of weapons), or are sectors where the government seeks to preserve state monopolies (such as postal companies) or protect Chinese firms from competition (such as mining of rare earth elements). Wayne M. Morrison, "China-U.S. Trade Issues," *Congressional Research Service*, March 17, 2015, 24.

Even if a foreign investment is permissible in accordance with the Catalogue, it must undergo a lengthy series of additional approvals to be established. These approvals and the processes for obtaining them typically vary depending on the structure of the investment, the specific industry, and local regulations.[12] Generally, a foreign investment must undergo the following approval processes: AML review, national security review, preapproval of enterprise name and corporate registration with the State Administration of Industry and Commerce (SAIC) or its local branches, approval of use of local land from various government authorities, project approval from the NDRC and local development and reform commissions (DRCs), foreign investment approval from MOFCOM, regulatory approval, and other administrative registrations (see Figure 3).[13]

**Figure 3: General Approval Process for FDI in China**




*Note:* WFOE is wholly foreign-owned enterprise. AIC is Administration for Industry and Commerce. SASAC is State-Owned Assets Supervision and Administration Commission.
*Source:* U.S. Chamber of Commerce, "China's Approval Process for Inbound Foreign Direct Investment: Impact on Market Access, National Treatment and Transparency," 2012, 10.

### *Industrial Policies*

China's national economic goals are bolstered by industrial policies, which are designed to support the development of domestic industries and the creation of national champions.[14] To ensure inbound FDI supports these goals, the Chinese government identifies different industries as desirable for or restricted to foreign investment in the Catalogue. In addition to the Catalogue, other laws and regulations allow industrial policies to dictate treatment of foreign investors in certain industries. For example, while China's AML enforcement decisions reference competition law and cite alleged threats to competition, in reality these decisions do not always promote competition, and in some cases actually hinder it, in furtherance of Chinese industrial policy objectives.[15] (For more de-

tails on China's industrial policies, see Chapter 1, Section 3, "China's State-Led Market Reform and Competitiveness Agenda," in this Report.)

*Review and Appeal Processes*

Foreign investors who fail to gain approval face a daunting appeals process that, in the end, frequently reverts to a decision in favor of domestic competitors regardless of the merits of the case. If a foreign investor feels an application has been unreasonably denied by Chinese authorities, the investor may appeal.* In practice, however, the appeal process has severe limitations, and foreign investors seldom use it.[16] For one, the grounds for denying investment applications are very broadly defined, and approval authorities are not required to approve applications submitted to them even if all requirements are clearly met. Another factor that discourages foreign investors from pursuing administrative appeal is the difficulty in producing solid evidence of inappropriate conduct on the part of reviewing agencies, given such misconduct is often informally or orally executed. A third factor is that the decisions of approval authorities and the People's Courts are all subject to the supervision of the Chinese Communist Party (CCP), and are expected to align with the Party's underlying policies.[17]

## Challenges for Foreign-Invested Enterprises in China

Overall, China remains a profitable market for U.S. companies, though profitability levels are decreasing.[18] According to a survey conducted by the US-China Business Council (USCBC), 85 percent of respondents † described their operations in China as profitable, but at lower profit margins than in previous years due to rising costs.[19] Similarly, 73 percent of companies ‡ surveyed by the American Chamber of Commerce in China (AmCham China) described their China operations in 2014 as profitable.[20] In both surveys, roughly two-thirds of respondents reported profit margins in China comparable to or higher than margins for their company operations in other markets.[21]

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* In theory, a rejected foreign investor may apply for administrative reconsideration within 60 days of the contested decision; the reviewing agency may affirm or nullify the original administrative decision within 60 to 90 days. If the applicant is not satisfied with the reviewing agency's decision, or if the reviewing agency has failed to act, the applicant may bring an administrative lawsuit within 15 days of the reconsideration decision. U.S. Chamber of Commerce, "China's Approval Process for Inbound Foreign Direct Investment: Impact on Market Access, National Treatment and Transparency," 2012, 20.

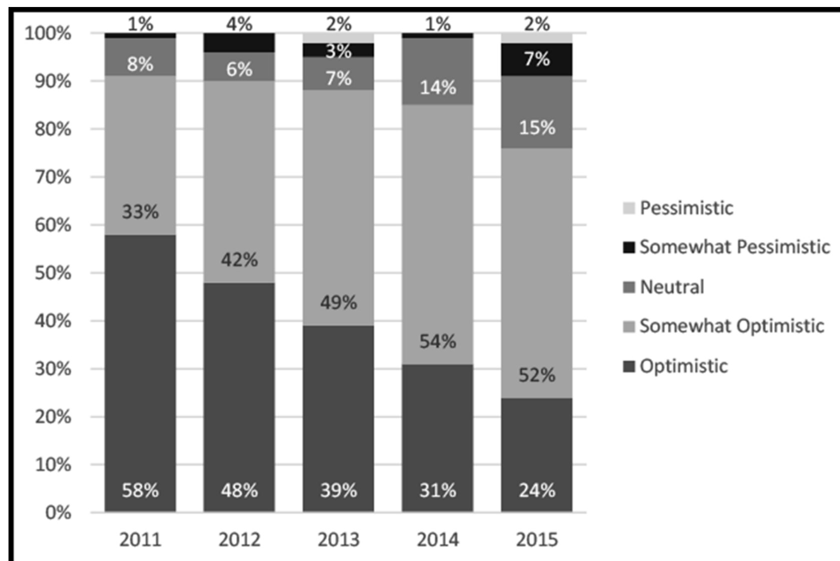
† The USCBC's 2015 China business environment survey analyzed responses from 106 companies, representing roughly half of its member companies. Fifty-eight percent of respondents operate in the manufacturing sector, 47 percent in the services sector, and 13 percent in primary industries such as agriculture. The majority of respondents have been operating in China for more than 20 years. US-China Business Council, "USCBC 2015 China Business Environment Survey Results: Growth Continues amidst Economic Slowdown, Rising Competition, Policy Uncertainty," 2015, 33.

‡ AmCham China's 2015 business climate survey analyzed responses from 477 companies, representing 47 percent of the organization's 1,012 member companies. Respondent companies were fairly evenly distributed across four lines of business, with approximately 30 percent in the resources and industrial sector, approximately 25 percent in the services (excluding information services) sector, approximately 25 percent in the information/knowledge-based services sector, and approximately 15 percent in research and development (R&D)-intensive industries. Nearly 40 percent of respondents forecasted a revenue of $100 million or more for 2014. American Chamber of Commerce in the People's Republic of China, "2015 China Business Climate Survey Report," February 2015, 7.

Though the majority of U.S. firms still consider China a profitable market, optimism is waning (see Figure 4). According to AmCham China's 2015 member survey, 29 percent of respondents described the foreign investment environment in China as deteriorating—an increase of 11 percentage points from the previous year—with 2 percent fewer companies reporting improvements in the environment (see Figure 5).[22] Nearly half of companies surveyed—a 3 percent increase from the previous year—reported foreign enterprises are less welcome in China than in previous years.[23] Members of the EU Chamber of Commerce in China (European Chamber) are similarly concerned: only 58 percent of survey respondents* in 2015 were optimistic about the growth outlook in China—a 10-point drop from 2014, and an all-time low—while only 28 percent of respondents were optimistic about profitability in the next two years.[24]

**Figure 4: Five-Year Outlook for Business in China, 2011–2015**

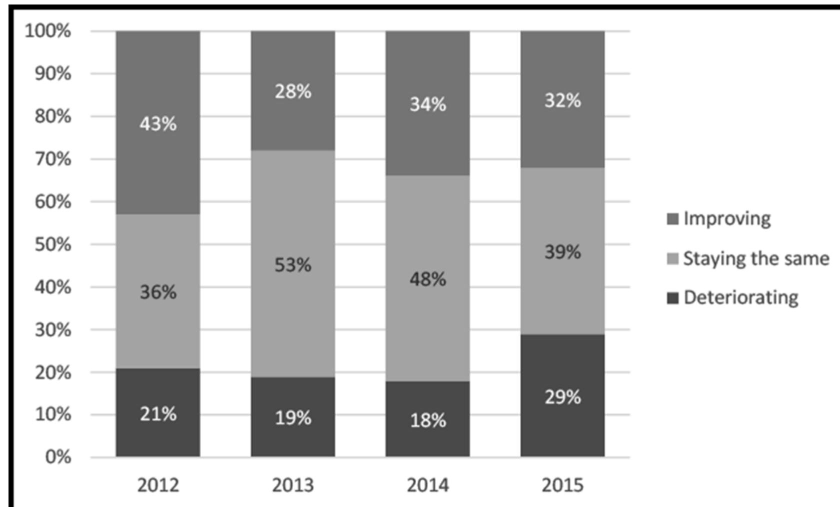
(surveyed U.S. companies)




*Source:* US-China Business Council, "USCBC 2015 China Business Environment Survey Results: Growth Continues amidst Economic Slowdown, Rising Competition, Policy Uncertainty," 2015, 5.

* The European Chamber's 2015 member survey analyzed responses from 541 respondents, or 37 percent of 1,474 member companies. The various industries were represented almost equally, with 37 percent of respondents in the industrial goods and services sector, 35 percent in the consumer goods and services sector, and 27 percent in the professional services sector. The majority of respondents are small- and medium-sized enterprises that employ fewer than 250 employees, and 54 percent of those surveyed have been operating in mainland China for more than ten years. EU Chamber of Commerce in China, "Business Confidence Survey," June 2015, 57–59.

**Figure 5: Quality of China's Foreign Investment Environment, 2012–2015**
(surveyed U.S. companies)




*Source:* American Chamber of Commerce in the People's Republic of China, "2015 China Business Climate Survey Report," February 2015, 19.

While some of the challenges—including rising labor costs and human resources constraints—cited by foreign investors in China stem from the country's economic slowdown, investors also attribute the worsening business climate in China to the restrictive legal and regulatory framework for foreign investment and the government's discretionary, uneven enforcement thereof (see Table 2). These challenges are exacerbated by the Chinese government's industrial policies, which serve to support domestic companies in sectors deemed strategic to the development of the national economy by extracting advantages from foreign competitors. For example, 53 percent of companies in both the resources and industrial sector * and research and development (R&D)-intensive industries †—sectors where China's industrial policies favor domestic companies and authorities impose localization requirements on foreign companies—felt the least welcome.[25] In contrast, investors in the services (excluding information services) sector ‡ largely reported improvements in the investment environment, likely due to the recent relaxing of foreign investment restrictions in that sector to boost domestic consumption.[26] Optimism among European companies surveyed reflected a similar division: those in industrial goods and services were least optimistic about future growth and profitability,

* The AmCham China survey categorizes the following industries as part of the resources and industrial sector: agriculture; metals (mining and production); oil, energy, and power; chemicals; construction, architecture, and interior design; electronics; automotive; cosmetics; other manufacturing and sourcing; and other consumer goods.

† The AmCham China survey categorizes the following as R&D-intensive industries: information, communications, and technology; clean technology; aerospace; pharmaceuticals; and environmental protection.

‡ The AmCham China survey categorizes the following industries as part of the services (excluding information services) sector: hospitality; food and beverage; healthcare services; real estate and development; banking and financial services (other than insurance); insurance; retail and distribution; transportation and logistics; and travel and leisure.

while those in professional services and consumer goods and services were more optimistic.[27]

**Table 2: Top Business Challenges for Foreign Firms in China, 2015**
(surveyed U.S. and European companies)

| | USCBC, 2015 | AmCham China, 2015 | European Chamber, 2015 |
|---|---|---|---|
| **1** | Competition with Chinese companies in China | Labor costs | Chinese economic slowdown |
| **2** | Foreign investment restrictions | Inconsistent regulatory interpretation/Unclear laws | Rising labor costs |
| **3** | Cost increases | Shortages of qualified employees | Global economic slowdown |
| **4** | Intellectual property rights (IPR) enforcement | Shortage of qualified management | Market access barriers and investment restrictions |
| **5** | Transparency | Increasing Chinese protectionism | Competition from Chinese privately owned enterprises |
| **6** | Licensing | | Renminbi (RMB) volatility |
| **7** | Human resources | | Ambiguous rules and regulations |
| **8** | Data flows | | Talent attraction and retention |
| **9** | Uneven enforcement | | Discretionary enforcement of regulations |
| **10** | Overcapacity in the China market | | Lack of sufficient and qualified talent |

*Note:* Derived from latest information available. AmCham China only releases the top five business challenges in its survey.
*Source:* US-China Business Council, "USCBC 2015 China Business Environment Survey Results: Growth Continues amidst Economic Slowdown, Rising Competition, Policy Uncertainty," 2015, 1; American Chamber of Commerce in the People's Republic of China, "2015 China Business Climate Survey Report," February 2015, 20; EU Chamber of Commerce in China, "Business Confidence Survey," June 2015, 17.

During the Commission's trip to Beijing and Hong Kong in July, U.S. business representatives expressed grave concern about the "chilling effect" of a new series of Chinese laws on the prospects of foreign companies, saying they could seriously harm foreign firms' ability to do business there, especially in IP-intensive sectors.[28] The laws identified as most problematic are the National Security Law, adopted July 1, which requires onshoring of R&D, among other requirements; the draft Cybersecurity Law, which authorizes broad discretion to control the flow of information online; a draft counterterrorism law, revised in February, which could require foreign companies to turn over encryption keys; and a draft law threatening the operations of foreign nongovernmental organizations (NGOs) in China.[29] One U.S. business representative in the financial services industry, for example, reports these laws prevent stakeholders from attending meetings in mainland China, result in transfer of data due to onshoring requirements, and have a detrimental impact on cross-border trade due to controls on the flow of information.[30] In effect, these laws counteract China's efforts to liberalize aspects of the foreign investment framework. While China's

market and investment barriers have been discussed in nearly every meeting of the U.S.-China Strategic and Economic Dialogue (S&ED), some U.S. business representatives argue S&ED outcomes have not been sufficiently implemented.[31]

### *Market Access Restrictions*

In general, according to World Bank calculations, starting a business in China is getting easier: globally, China ranked 128th out of 189 economies * in the ease of starting a business in 2015, a 23-position improvement in ranking since 2014.[32] However, continuing or expanding operations in China in certain sectors is getting increasingly difficult. Across industries, market access limitations are the primary inhibitors of U.S. companies' ability and willingness to invest in China (see Table 3).[33] China primarily maintains national-level market access restrictions through the Foreign Investment Catalogue, though local governments frequently employ region- or industry-specific Catalogues, further restricting access. Contradictions between the Catalogue and other measures serve to confuse investors, contributing to the perception among foreign-invested firms that investment guidelines do not provide a secure basis for business planning and undermine confidence in the stability and predictability of the investment climate.[34] Chinese authorities sometimes condition provision of market access on forced technology transfer or price suppression.[35] For example, during the Commission's July trip to Asia, U.S. business representatives in the information technology sector said foreign tech firms were required to form JVs with local partners in order to be allowed to provide cloud-based services.[36] The broad and potentially intrusive national security review mechanism as proposed in the new draft foreign investment law could also be used to hinder market access (see "National Security Review" later in this section).[37] U.S. business representatives who met with the Commission during its fact-finding trip to China this year said these measures reflect the Chinese government's concerns about protecting local competitors, resulting in unequal treatment toward foreign investors.[38]

**Table 3: Chinese Government Measures Limiting U.S. Investment, 2015**

| | **Services (excl. Information Services)** | **Information/ Knowledge-Based Services** | **R&D-Intensive Industries** | **Resources and Industrial** |
|---|---|---|---|---|
| **1** | Market access limitations | Market access limitations | Market access limitations | Market access limitations |
| **2** | Local partner/ equity requirements | Local partner/equity requirements | Targeted enforcement for foreign firms | Chinese government funding provided solely for domestic competitors |
| **3** | Unequal approval process for investments | Targeted enforcement for foreign firms | Chinese government funding provided solely for domestic competitors | Targeted enforcement for foreign firms |

* A ranking of 1 denotes the easiest place to do business, and 189 is the most difficult. Data collected by the World Bank estimates starting a business in China on average requires 11 procedures, takes 31.4 days, costs 0.9 percent of income per capita, and requires no paid-in minimum capital.

**Table 3: Chinese Government Measures Limiting U.S. Investment, 2015**
***Continued***

| | Services (excl. Information Services) | Information/ Knowledge-Based Services | R&D-Intensive Industries | Resources and Industrial |
|---|---|---|---|---|
| **4** | Targeted enforcement for foreign firms | Unequal approval process for investments | De facto technology requirement for market access | Local partner/equity requirements |
| **5** | Chinese government funding provided solely for domestic competitors | Investment approvals | Local partner/equity requirements | Investment approvals |

*Source:* American Chamber of Commerce in the People's Republic of China, "2015 China Business Climate Survey Report," February 2015, 25.

### *Foreign Investment Catalogue*

In early 2015, MOFCOM and the NDRC jointly released an updated version of the Catalogue, the sixth amended version since it was first implemented in 1995.[39] Restrictions were eased, particularly for foreign-invested enterprises entering the service sector. Compared with its predecessor, the 2011 Catalogue, the 2015 version reduces the number of restricted sectors from 79 to 38; the number of sectors in which Sino-foreign JVs are required decreased from 43 to 15; and the number of sectors requiring Chinese majority shareholding fell from 44 to 35.[40] But industries the Chinese government has long sought to nurture as national champions—such as automobiles and healthcare—saw heightened restrictions. Industries no longer categorized as restricted include many manufacturing industries; e-commerce (excluding any value-added telecommunications services such as Internet access services);* land development, construction, and operation of high-end hotels and office buildings; investment in real estate secondary market and real estate brokerages; operation of golf courses and other entertainment venues; and nonbank financial institutions, trust companies, and currency brokerage companies.[41] In addition, the 2015 Catalogue uses tax incentives and subsidies to encourage wholly foreign-owned enterprises to establish and operate nursing homes.[42]

Despite these positive changes, restrictions remain largely intact in those industries—such as banking, telecommunications, and art and cultural industries†—that have consistently faced heavy con-

* Telecommunications services in China are divided into basic telecommunications services and value-added telecommunications services, which include: (1) online data processing and online transaction processing business, (2) domestic multiparty communication business, (3) domestic Internet virtual private network (VPN) business, (4) Internet data center business, (5) store and forwarding business, (6) call center business, (7) Internet access business, and (8) information service business. Karen Ip and Huang Yilin, "China: TMT Liberalized in the Shanghai FTZ: Part 1," *Mondaq*, November 18, 2014.

† Cultural industries include production and publication of broadcasting and television programs and films, construction and operation of cinemas and large theme parks, and brokering of stage performances. Art industries include publication of books, newspapers, and periodicals, production and publication of audio and visual products, electronic publications, and radio programs, and auction and antique auction businesses. "Catalogue for the Guidance of Foreign Investment Industries (Comparison of the English translations of the new 2015 Catalogue against the 2011 Catalogue)," Covington & Burling LLP, 2015.

trols on foreign investment.[43] Moreover, a number of restrictions on foreign investment in culture and entertainment industries that were originally removed from a 2014 draft version of the revised Catalogue were maintained in the 2015 version.[44] Additionally, some industries became more restricted to foreign investment.

- *Automobile (auto) manufacturing:* For the first time, the 2015 Catalogue designated the manufacturing of complete cars, specialty vehicles, and motorcycles as restricted, requiring at least 50 percent Chinese ownership. In the 2011 Catalogue, foreign investment was permitted in the industry, and in the 2004 Catalogue it was encouraged. Moreover, one foreign investor is not permitted to invest in more than two JVs manufacturing the same type of motor vehicle, except where the foreign investor acquires or merges with a Chinese JV partner.[45] While foreign equity restrictions have always been in place in some form in China's auto manufacturing industry, the new cap on JVs "may be implicitly aimed at encouraging the development of its self-owned branded vehicles."[46]

- *Medical institutions:* In contrast to the 2011 Catalogue, under which wholly foreign-owned enterprise investment into Chinese medical institutions was permitted, the 2015 Catalogue categorizes the industry as restricted, and limits foreign investment to JVs with Chinese partners.[47] This tightening of restrictions counteracts a MOFCOM pilot program implemented in July 2014 to allow foreign investors full ownership of medical institutions in seven pilot cities, implying foreign investors in this sector may meet increased challenges in obtaining the necessary regulatory approvals.[48] Two major U.S. groups—Massachusetts General Hospital and Columbia Pacific Management—have planned investments upward of $200 million for two hospitals in China under the pilot program, but municipal and provincial authorities have yet to specify the necessary steps to move forward.[49]

- *Educational services:* In addition to upper secondary school institutions, which were restricted under the 2011 Catalogue, tertiary (e.g., university) and preschool educational institutions are now restricted, and foreign investment is now limited to cooperative JVs with a Chinese partner.[50] Compulsory educational institutions (primary school through early secondary school) remain prohibited to foreign investors. The chief administrator of the JV must be a Chinese national, and the Chinese partner must account for at least half of the members on the board of directors.[51] Moreover, education provided by the JV must be unrelated to the military, law enforcement, politics or political parties, and religion.[52] The market for educational services in China is experiencing rapid growth: spending on education in China reached approximately $66 billion in 2014, and Chinese households spend 30 percent of their income on education.[53]

- *Legal services:* While the legal services industry was restricted to foreign investment in the 2011 Catalogue, the revised Catalogue categorizes the industry as prohibited, though it clarifies that foreign law firms may "provide information on the impact of the Chinese legal environment" in an effort to uphold China's World Trade Organization (WTO) commitments to do so.[54] Market access liberalization offered to foreign firms upon WTO accession was small—limited to opening one representative office, subject to approval—and the types of services they could provide were restricted.[55] Despite encouragement from WTO members to liberalize its legal services market, China has made little progress.[56]

**Market Access Barriers in China's Automotive Industry**

Over the past three decades, China's automotive industry has grown to become the world's top auto producer and biggest auto sales market.[57] According to global management consulting firm McKinsey & Company, China's auto sector grew at a compound average rate* of 24 percent per year between 2005 and 2011.[58] In 2010, China overtook the United States as the largest single-country market for new passenger cars, and by 2020 is expected to surpass both North America and Europe to become the biggest regional market.[59] As a result, the auto parts manufacturing industry in China is thriving: in 2015, industry revenue is expected to reach $567 billion, a 9.7 percent increase from the previous year.[60] Due to faster growth in domestic demand—China's vehicle ownership is projected to rise from 58 per 1,000 people in 2010 to 269 by 2030—most cars manufactured in China sell to domestic consumers.[61] Slowing economic growth and stock market volatility in China, however, have dampened auto sales growth in 2015. August passenger car sales fell 3.4 percent year-on-year, according to the China Association of Automobile Manufacturers, while future growth is projected to slow to approximately 5 percent annually over the next several years.[62]

Foreign automakers have been permitted to participate in this enormous market only through forming JVs—each no more than 50 percent controlled by the foreign manufacturer—with local partners, oftentimes state-owned enterprises (SOEs).[63] Since the opening of China's economy in the 1980s, foreign investment in auto manufacturing was limited to JVs under an informal auto development policy, which employed high tariffs and import quotas to protect the domestic market.[64] Restrictions on foreign ownership of JVs were maintained in the 1994, 2004, and 2009 versions of the Policy on Development of the Automotive Industry.[65] These industrial policies also mandated the creation of domestic R&D centers and transfer of technology to Chinese partners with the goal of generating indigenous IP.[66] According to U.S.-based industry group Information Technology Innovation

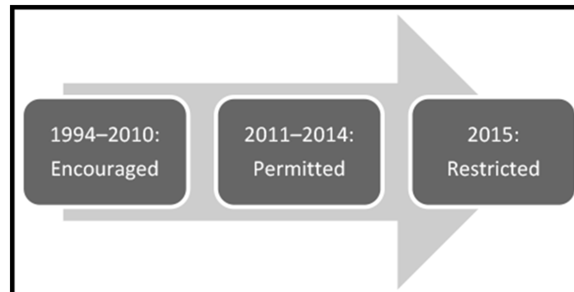
* Compound average growth rate is the mean annual growth rate over a specified period of time.

**Market Access Barriers in China's Automotive Industry—*Continued***

Foundation, these policies fail to deliver on China's WTO commitments not to condition market access on whether a company transfers technology or conducts R&D in China.[67]

China has also pursued policies designed to promote the development of a domestic new energy vehicle (NEV) market.[68] After production of NEVs was identified in the 12th Five-Year Plan (2011–2015) as a "strategic emerging industry," foreign manufacturers were told by NDRC officials that approval to manufacture electric vehicles in China would be granted only if they assume a minority stake in a JV, transfer certain core technology, and agree to local branding for the vehicles.[69] Moreover, only domestic NEVs qualify for consumer subsidies and other incentive programs maintained by the Chinese government, raising national treatment concerns.[70] Correspondingly, the whole auto manufacturing industry * changed from "encouraged" for foreign investment in 2007 to "permitted" in the 2011 Catalogue, and in 2015 is now categorized as "restricted" (see Figure 6), with limitations on the number of JVs one foreign investor can participate in—except where the foreign investor acquires or merges with a Chinese partner.[71]

**Figure 6: Foreign Investment Catalogue Classification of Whole Auto Manufacturing**




Despite policy uncertainty and discrimination, foreign auto manufacturers have still managed to dominate China's domestic auto sales and manufacturing markets. In 2014, foreign brands accounted for 62 percent of passenger vehicle sales in China, with international JVs comprising the top five carmakers by sales in China (see Table 4).[72] General Motors China (GM China) alone has 11 JVs and two wholly-owned foreign enterprises † in China; in 2014, GM China's domestic sales of all vehicles rose 12 percent to 3.5 million units, or 15 percent of the 23.7 million vehicles sold in China in 2014.[73]

* On an industry basis, the manufacturing of whole automobiles is separate from the manufacturing of auto parts.

† One of GM's two wholly foreign-owned enterprises is an investment company, and the other is a parts distribution center. As neither produces automobiles or parts, they are not subject to foreign equity restrictions.

**Market Access Barriers in China's Automotive Industry—*Continued***

**Table 4: Top Passenger Car Sales in China by Carmaker, 2014**

| Rank | Carmaker | Foreign Company | Chinese Company | Sales (by unit) | Market Share |
|---|---|---|---|---|---|
| 1 | FAW Volkswagen | Volkswagen | FAW | 1,780,888 | 9.04% |
| 2 | Shanghai Volkswagen | Volkswagen | SAIC | 1,725,006 | 8.75% |
| 3 | Shanghai GM | General Motors | SAIC | 1,723,940 | 8.75% |
| 4 | SAIC–GM–Wuling | General Motors | SAIC and Wuling | 1,586,383 | 8.05% |
| 5 | Beijing Hyundai | Hyundai | BAIC | 1,120,048 | 5.68% |
| 6 | Changan | n/a | Changan | 975,431 | 4.95% |
| 7 | Dongfeng Nissan | Nissan | Dongfeng Motor | 951,710 | 4.83% |

*Note:* FAW is First Automobile Works; SAIC is Shanghai Automotive Industry Corporation; BAIC is Beijing Automotive Industry Corporation. These figures cover two- or three-box sedans, multipurpose vehicles, micro vans, and sport utility vehicles. Pickup trucks, buses, and other commercial vehicles are not included.
*Source:* China Passenger Car Association via ChinaAutoWeb, "2014 Passenger Car Sales by Maker," January 12, 2015.

China's auto policies nonetheless pose risks to foreign automakers. According to the Office of the U.S. Trade Representative (USTR) 2014 report to Congress on China's WTO compliance efforts, China's auto sector industrial plans—including discrimination based on the country of origin of IP, forced technology transfer, R&D requirements, investment restrictions, and discriminatory treatment of foreign brands and imported vehicles—include guidelines that "appear to conflict with its WTO obligations." [74] In response to China's 2004 and 2005 industrial policies in the automotive industry, the United States, the EU, and Canada initiated dispute settlement proceedings against China at the WTO * in 2006, charging that China unfairly discriminated against imported automotive parts.[75] The WTO panel ruled in favor of the complaining parties in March 2008; China's appeal of the decision was rejected later that year. In 2009 China repealed its discriminatory rules on automobile parts, but "more work remains to be done" to address the full host of concerning policies, according to the USTR's 2015 *National Trade Estimate Report on Foreign Trade Barriers*.[76]

These fluctuations in China's foreign investment restrictions reflect a pattern whereby the government welcomes FDI into sectors

* Upon accession to the WTO in 2001, China committed to lift restrictions on vehicle manufacturers regarding categories, types, or models of vehicles permitted for production, and to increase limits within which investment in motor vehicle manufacturing could be approved by provincial governments, within two years. U.S. Department of State, *2015 Investment Climate Report—China*, May 2015, 20.

designated as strategic for China's national economic development in order to extract technology, IP, and know-how from foreign firms. However, after domestic industry is deemed sufficiently developed, policies welcoming investment are gradually withdrawn and new policies restricting investment are put in place to free up market space for domestic firms and push out foreign firms. Within a legal framework subject to opaque rule-making procedures and designed to serve CCP interests, U.S. investors seemingly have little to no recourse to protect their rights or effectively resolve disputes.[77] Moreover, because "there are no accepted techniques for estimating the impact of [investment barriers] on U.S. investment flows," according to the USTR, it is difficult to quantify the effect of China's restrictive investment policies.[78]

Despite these concerns, few foreign companies report that they plan to reduce or stop a planned investment in China. Only 14 percent of USCBC survey respondents in 2014 indicated they canceled a planned investment in the previous year, most citing better business prospects in another country; increasing market access restrictions and reduced capital investment globally were the next most cited reasons for decreased China investments.[*][79] Among AmCham China survey respondents whose planned increase in investment in 2015 is lower than it was in 2014, the primary causes of their decision were expectations of slower growth in China compared with faster-growing markets elsewhere and market access barriers or government policies that disadvantage foreign companies.[80] On the whole, European companies exhibited growing unwillingness to expand current China operations in 2015—those not considering expansion grew from 6 percent in 2013 to 31 percent in 2015. However, on a sectoral basis, the majority of surveyed European companies in the professional services, automotive and auto components, and medical devices industries are considering expanding current China operations in 2015.[81]

### *China's Inconsistent and Opaque Anti-Monopoly Law Enforcement*

Discretionary, unclear legal and regulatory interpretation and weak or inconsistent enforcement have consistently ranked among the top business challenges for U.S. companies in China.[82] European Chamber companies likewise cited the discretionary enforcement of regulations as one of the top regulatory obstacles to doing business in China.[83] In recent years, a broad range of Chinese regulatory activities seem to have focused disproportionately on foreign investors across various industries of strategic importance to China's national economy. AmCham China's 2015 member survey indicated that 57 percent (271 companies) of 477 respondent companies believe foreign firms are being singled out in the government's recent campaigns; of those 271 companies, 65 percent are concerned that such campaigns will have a detrimental impact on their companies, while 52 percent report these campaigns have a negative impact on their companies' intent to invest.[84]

In 2013 and 2014, China's increased enforcement of the AML, in particular against high-profile foreign companies, garnered inter-

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[*] Information regarding planned investments was not published in the USCBC's 2015 survey.

national attention from industry, government, and media actors. According to the U.S. Chamber of Commerce, although China's AML has been used to foster competition in line with international legal practices, "China has also employed [the AML] both domestically and extraterritorially to pursue [industrial policy] objectives that have no place in a free, open, and fair market-based economy." [85] Further, Chinese enforcement agencies appear to use the threat of AML investigations against foreign actors to control price and supply of goods to the benefit of Chinese market participants.[86] Due to a lack of transparency in China's investigation and enforcement decisions, it is not possible to conclusively assess whether foreign companies have been targeted in these campaigns; however, they do appear to have been subject to unequal treatment.

*History of China's AML*

Compared with other advanced economies, China's competition regime is relatively nascent. Its AML came into force in 2008 after Chinese authorities spent more than a decade drafting the law and consulting with foreign competition authorities from the United States, the EU, and other jurisdictions. The AML draws from elements of both the U.S. and EU competition laws, though it is more closely tied to the EU model,* and contains some elements unique to China.[87]

China's AML allows for the consideration of noncompetitive factors, namely industrial policy, in its application and enforcement. Examples include articles that emphasize the need to harmonize competition policy with the specific needs of China's socialist market economy (Articles 1 and 4), encourage mergers and acquisitions (M&As) as a means to achieve economic scale (Article 5), institute national security reviews of Chinese M&A transactions with foreign companies (Article 31), and prohibit the abuse of IP † to eliminate or restrict market competition (Article 55).[88]

Three government agencies are primarily responsible for AML enforcement in China. The NDRC handles price-related conduct, including investigations of pricing practices by companies, price-related aspects of monopoly agreements, and company abuse of dominant market position to set or control prices, via its Price Supervision and Anti-Monopoly Bureau. MOFCOM reviews M&A transactions and other types of proposed business concentrations via its antimonopoly bureau. The State Administration for Industry and Commerce (SAIC) investigates non-price-related monopolistic be-

* Following the EU model, China's AML purports to develop a healthy economy, prioritize economic integration, promote fairness for business operators of varying sizes, and support technology development alongside consumer interests. US-China Business Council, "Competition Policy and Enforcement in China," September 2014, 3–4.

† Chinese regulators seek to prevent IP rights holders with dominant positions in relevant markets from misusing these rights or engaging in abusive practices in the name of exercising their IP rights. These behaviors constitute abuse of dominance only where they eliminate or restrict competition in the relevant market. However, the AML does not clearly define the relevant markets involving IP rights, nor does it define the standards for determining abuse of dominance. As a result, Chinese regulators reportedly have pressured foreign firms in some sectors to disclose IP content or license it to domestic competitors at below-market rates, under threat of "abuse of intellectual property" allegations. For an example of the application of this article of the AML, see the Qualcomm textbox later in this section. Hao Zhan, "Abuse of Dominance in Relation to Intellectual Property: The Chinese Perspective," *AnJie Law Firm*, October 9, 2014.

havior, including monopoly agreements, abuse of market dominance, and monopoly control, via its Anti-Monopoly and Anti-Unfair Competition Bureau.[89]

*U.S. Business Concerns Regarding China's AML Enforcement*

In its 2014 member company survey, the USCBC found over 86 percent of companies surveyed indicate they are somewhat or very concerned* about China's increased AML enforcement activity, with 56 percent of companies indicating enforcement is a primary concern regarding China's competition policy.[90] U.S. companies are most concerned about the following issues:

- *Fair treatment and nondiscrimination:* While it is not clear that enforcement activities target foreign companies, consideration of nonmarket factors (industrial policy), legal ambiguity and the discretionary legal framework, and the lack of transparency in pricing decision procedures lead some analysts to conclude that Chinese authorities emphasize industrial policy priorities over free market and competitive considerations.[91]

- *Lack of due process and regulatory transparency:* Throughout Chinese antitrust enforcement activities in 2013 and 2014, U.S. companies have reported the following procedural shortcomings:
  - Pressure to admit guilt without the ability to see and respond to evidence;
  - Restricted access to legal representation at unannounced onsite investigations;
  - Restricted access to foreign outside legal representation at ongoing proceedings;
  - Insufficient transparency during competition reviews;
  - Insufficient transparency in publishing case decisions;
  - Lack of effective appeal process; and
  - Threats to personal safety.[92]

- *Use of noncompetitive factors in enforcement:* U.S. companies are concerned enforcement agencies use the AML to protect Chinese companies, industries, and policy goals such as innovation, patent creation, and technology licensing from foreign competition.[93]

- *Broad definition of monopoly agreements:* U.S. companies complain that China's competition enforcement deviates from international best practices. For example, Article 14 of the AML appears to prohibit manufacturers from signing specific kinds of pricing agreements and "other monopoly agreements" with distributors.[94] However, the interpretation of "other monopoly agreements" is to be determined by the NDRC or the SAIC. As a result, companies fear agreements they sign could be arbitrarily construed as monopolistic.

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*Surveyed companies described their level of concern as either "very concerned" (25 percent), "somewhat concerned" (61 percent), or "not concerned" (14 percent). US-China Business Council, "USCBC 2014 China Business Environment Survey Results: Growth Continues amidst Rising Competition, Policy Uncertainty," 2014, 20.

*MOFCOM's AML Enforcement Activities: Reviews of Mergers and Acquisitions*

In its reviews of proposed M&As, China's MOFCOM has exclusively blocked or modified transactions involving foreign companies, and imposed remedies that tend to protect and promote domestic industry and cap commodity prices and IP royalties.[95] According to its year-end work report, MOFCOM's antitrust enforcement sharply intensified in 2014: it reviewed 245 cases, the highest number of cases reviewed by MOFCOM in a single year since the law's implementation in 2008.[96] From August 2008 through the first quarter of 2015, MOFCOM unconditionally approved 97.5 percent of the 1,062 total transactions it reviewed (see Table 5). All of the 26 transactions that were either rejected or conditionally approved involved foreign firms; 21 of the 26 cases involved foreign-to-foreign transactions (see Addendum I).* [97] The two transactions rejected by MOFCOM were in the beverage manufacturing and transportation shipping industries. Among the 24 conditionally approved transactions, 25 percent involved the manufacturing of high-technology goods like electronics components, computer components, or mobile devices, while the remainder involved a variety of different industries.

**Table 5: Merger Reviews Completed by MOFCOM, 2008–2015**

| Year | Approved | | Rejected | Total Reviewed |
|---|---|---|---|---|
| | Unconditionally | Conditionally | | |
| **2008** | 16 | 1 | 0 | 17 |
| **2009** | 72 | 4 | 1 | 77 |
| **2010** | 113 | 1 | 0 | 114 |
| **2011** | 164 | 4 | 0 | 168 |
| **2012** | 158 | 6 | 0 | 164 |
| **2013** | 211 | 4 | 0 | 215 |
| **2014** | 240 | 4 | 1 | 245 |
| **2015Q1** | 62 | 0 | 0 | 62 |
| **Total** | 1,036 | 24 | 2 | 1,062 |

*Source:* US-China Business Council, "Update: Competition Policy & Enforcement in China," May 2015, 9; China's Ministry of Commerce, *MOFCOM's 2014 Year-End Roundup: Rolling out Antimonopoly Work in Accordance with the Law to Protect Fair Market Competition*, January 29, 2015. Staff translation.

* For comparison, only one-third of conditional approvals and rejections issued by the United States between 2008 and 2012 involved foreign-to-foreign transactions; in the EU, only 54.3 percent of such decisions between 2008 and 2013 involved non-EU companies. U.S. Chamber of Commerce, "Competing Interests in China's Competition Law Enforcement," September 2014, 31.

While all M&A transactions, foreign or domestic, that satisfy the applicable monetary threshold must be reported to MOFCOM,* evidence suggests most qualifying domestic M&A transactions are not reported. Domestic-to-domestic transactions account for approximately 80 percent of M&A deals with a Chinese target, but from August 2008 to 2014, only 7.6 percent of the transactions decided by MOFCOM were domestic-to-domestic, suggesting the majority of such transactions were not submitted to MOFCOM for review.[98] By not reporting to MOFCOM, many domestic-to-domestic transactions were effectively exempted from AML requirements and rigorous review.[99] Even though most M&A transactions reviewed by MOFCOM are approved, the imbalance in reporting expectations across domestic and foreign M&A transactions puts foreign companies at a disadvantage by unfairly and disproportionately exposing them to increased scrutiny, regulatory uncertainty, approval delays, and associated costs. In December 2014, MOFCOM announced its first published decision penalizing a prominent SOE for failing to report a merger.[100] The company in question, Tsinghua Unigroup, was fined $48,300 (RMB 300,000) for completing its $907 million acquisition of RDA Microelectronics in November 2013 without reporting the merger to MOFCOM, in violation of Article 21 of the AML.[101]

*NDRC's AML Enforcement Activities: Pricing Investigations*

The NDRC's Price Supervision and Anti-Monopoly Bureau investigates pricing-related anticompetitive conduct. Between 2008 and 2012, the NDRC conducted nearly 20 pricing-related investigations, according to media reports.[102] Starting in 2013, the NDRC's enforcement activities increased sharply: the agency investigated more than 80 companies in 2013, and more than 150 companies and branches in 2014.[103]

Throughout China's intensification of AML enforcement efforts in 2013 and 2014, U.S. business groups have found the NDRC enforces the AML disproportionately against foreign companies to achieve industrial policy goals unrelated to the protection of competition.[104] The NDRC's antitrust enforcement officials, however, deny these allegations. On the sidelines of the Summer Davos Forum in September 2014, Xu Kunlin, then head of the NDRC's Price Supervision and Anti-Monopoly Bureau, asserted "there is no selective law enforcement" between foreign and domestic firms or private and SOEs, despite the CCP's dual role as both SOE owner and regulator.[105] According to Mr. Xu, as of September 2014, only 10 percent of the 335 enterprises and industry associations investigated by the NDRC for monopolistic conduct were foreign firms.[106] In a joint statement, the three Chinese antitrust enforce-

* Normally, cases are reviewed if global turnover or Chinese turnover in the previous year surpasses certain thresholds. In 2014, MOFCOM promulgated two regulations to simplify premerger filing procedures. To determine whether a proposed transaction can be filed under simplified procedures, MOFCOM adopts both "market share thresholds"—to determine whether an enterprise has a dominant position in a certain market—and nonmarket share tests to determine whether the transaction will affect the Chinese economy. These regulations can be seen as a positive development in China's AML enforcement in that simplified filing requires less paperwork and takes less time for approval, but there is still a degree of uncertainty in the exceptions for simplified filing procedures. For more specific details on MOFCOM filing procedures, see Amigo Lan Xie, Cecillia Dai, and Aqua Huang, "What Is Simplified under Anti-Monopoly Filing Procedures for Simple M&A Cases?" *K&L Gates*, February 12, 2015.

ment agencies argued that large market positions make multinational corporations "inevitably the main object of market regulators" in recent campaigns, resulting in the appearance of targeted enforcement.[107]

Based on a number of industry, legal, and academic reports, news articles, and Chinese government websites, announcements, and press conferences, research by Commission staff into the NDRC's enforcement activities as of September 2014 found foreign-invested firms constituted approximately 19 percent of the roughly 276 enterprises or associations implicated in price-related antimonopoly investigations—9 percentage points higher than the figure cited by Mr. Xu (see Addendum II). Across a case sampling expanded to include all known completed cases through September 2015, approximately 26.3 percent of entities subject to NDRC penalty decisions for price-related AML violations were foreign-invested entities. This updated case sampling covers a total of 36 completed price-related cases in which at least 269 enterprises and trade associations in total were penalized.* Foreign-invested enterprises also feature prominently in the NDRC's ongoing cases, but the lack of detail provided in investigation announcements makes the proportion of cases involving foreign-invested firms difficult to assess.

On an industry basis, the nearly $300 million in fines imposed by the NDRC in major antitrust cases in 2014 were most concentrated in four sectors: the automotive industry (cases involving 12 Japanese auto parts and bearing manufacturers, Audi, and Chrysler), the insurance sector (a case involving 23 Zhejiang insurance companies), the cement sector (a case involving three Jilin cement companies), and the eyeglass and contact lens market (a case involving seven foreign manufacturers).[108] On average, fines imposed by the NDRC in pricing investigations are higher for foreign companies (3.3 percent of previous year's sales revenue in China) than for domestic companies (2.5 percent of previous year's sales revenue in China).[109]

China's AML is ambiguous in its application of jurisdiction, definition of key terminology, and determination of penalty amounts; offers poor procedural protection; and provides for very limited disclosure of decisions.[110] Because the law employs vague legal terms and leaves broad space for enforcement agencies to exercise discretionary power, the agencies, especially the NDRC and local development and reform commissions, have not exercised their power in a fair, equal, and transparent way.[111] Moreover, the administrative decisions of the NDRC and local commissions are short on evaluation of the effect of a certain behavior on competition, and lacking in evidence of why an actor should be exempted from punishment or receive a heavier or reduced fine.[112] The lack of an effective mechanism for controlling the overly broad discretion granted by the AML to enforcement agencies results in inconsistent decisions and unequal treatment: analysis of the NDRC's publicly available investigation and penalty decisions suggests the NDRC "failed to

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*Additional information on monopoly offenses investigated by the NDRC but not disclosed on the NDRC's website can be found in Zhang Xingxiang, "China's Anti-Monopoly Law Enforcement: A Quest for Transparency, Consistency and Fairness," *Indiana University Research Center for Chinese Politics and Business* Working Paper #37, April 2015, Appendix 2, 12–13.

treat [the] same or similar cases[s] equally," resulting in more leniency toward SOEs, more rigorous enforcement against foreign companies, and substantially varied penalties imposed on companies, regardless of nationality of the controlling shareholder, in similar circumstances.[113]

*SAIC's AML Enforcement Activities: Non-Pricing Monopoly Investigations*

The SAIC and its local branches handle non-pricing-related monopoly conduct and behavior constituting unfair competition, such as abuse of dominant market position and horizontal monopoly agreements. According to the agency's official website, the SAIC had launched 45 monopoly investigations as of January 28, 2015, and had completed 20 of those cases.[114] In 2014, the SAIC investigated 15 new monopoly cases, one-third of all its monopoly cases since 2008, pointing to an intensification of AML enforcement activity.[115] In addition to monopoly cases, the SAIC investigated more than 34,000 cases of unfair competition in 2014 alone.[116] None of the known completed cases involved foreign companies, but two ongoing investigations were launched into Swedish company Tetra Pak in July 2013 and Microsoft in July 2014, both alleging abuse of market dominance (see Addendum III).

*Additional Factors Contributing to China's Uneven AML Enforcement*

At the Commission's January hearing, three experts testified that while industrial policy is a consideration in China's AML enforcement, the extent of its role in investigation and penalty decision making is not known due to a lack of transparency on the part of authorities. Because China's AML regime is nascent compared with other established antitrust regimes, however, a number of structural and political factors skew its AML enforcement outcomes. Scholars of Chinese antitrust law generally agree the following additional factors contribute to China's uneven AML enforcement:

- *Competition between agencies:* Because antitrust enforcement is split among the NDRC, the SAIC, and MOFCOM, the agencies compete with each other for antitrust policy control.[117] Moreover, each agency's mandate underlies its style of AML enforcement. The NDRC is responsible for macroeconomic management and industrial policy, and so tends to rely on government intervention to solve economic problems.[118] MOFCOM is responsible for formulating trade and investment policies, and so is perceived to be friendlier to free-market policies. The SAIC is smaller and focuses on administration of enterprises and consumer protection, and so tends to play a smaller role in antitrust enforcement.

- *Poor coordination and unclear jurisdiction across agencies:* There is a risk of conflicting or diverging interpretations between the NDRC and the SAIC. For example, while both agencies may pursue investigations of alleged IP abuses, the dis-

tinction between price-related and non-price-related conduct in such cases is not always clear.[119] In at least one instance where an antitrust violation came under the jurisdictions of both the NDRC and the SAIC, the NDRC exercised jurisdiction, even though the offense was not price related.[120]

- *Lack of resources:* MOFCOM is understaffed compared to other merger review antitrust agencies in large jurisdictions elsewhere in the world. In 2012, MOFCOM's antimonopoly bureau was staffed with only 35 people to review hundreds of transactions, resulting in heavy delays for M&A reviews.[121] As of February 2014, the NDRC and the SAIC had about 15 and 8 staff members working on antitrust enforcement, respectively.[122] Local- and provincial-level bureaus are better staffed, as investigation and enforcement work tends to fall to local agencies.

- *Discrepancies between national- and local-level agencies:* Both the NDRC and the SAIC have extensive networks of corresponding bureaus at various levels of regional government, and so can delegate their enforcement responsibilities to local authorities. In both agencies, the majority of cases were initiated and enforced by local antitrust agencies.[123] Local authorities face pressure from local governments and local SOEs, while national-level authorities tend to intervene in high-profile cases to achieve broader policy objectives.[124]

- *Lack of judicial oversight:* Since the AML went into effect, no defendant has appealed any administrative decision made by the enforcement agencies for three main reasons: (1) fear of backlash from the enforcement agencies and other ministries; (2) "miniscule" likelihood of winning such a case; and (3) the NDRC's practice of granting leniency or complete immunity to companies that admit their guilt, creating a race to confess among firms.[125]

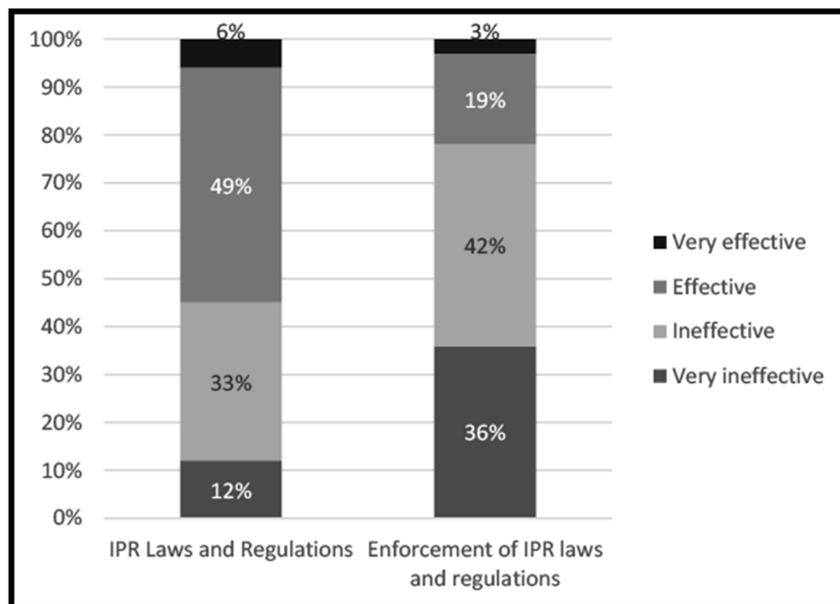
- *Lack of transparency:* To date, the NDRC has not published the rationale for any of its investigations, penalties, or other determinations in the context of AML enforcement.[126] In the last year, MOFCOM and the SAIC have stepped up efforts to publish relevant decisions on their official websites.

### *Antitrust and Intellectual Property*

In 2015, U.S. companies surveyed by AmCham China reported an overall improvement in the effectiveness of China's intellectual property rights (IPR) laws and regulations, but more than 75 percent rated China's IPR enforcement thereof as either ineffective (42 percent) or very ineffective (36 percent), as shown in Figure 7.[127] Likewise, 56 percent of European Chamber members rated China's IPR law enforcement as "inadequate." * [128]

* Survey respondents could choose to describe enforcement as excellent, adequate, inadequate, or not applicable.

**Figure 7: Effectiveness and Enforcement of China's IPR Laws and Regulations**
(surveyed U.S. companies)




*Source:* American Chamber of Commerce in China, "2015 China Business Climate Survey Report," February 2015, 29.

U.S. companies are particularly concerned about the application of the AML in the field of IP. According to the U.S. Chamber of Commerce, the NDRC appears to have used the threat of AML investigations against at least two U.S. companies, InterDigital and Qualcomm (see Addendum II), to attempt to lower the licensing fees charged to would-be Chinese licensees, usually telecommunications and electronic equipment producers like Huawei, effectively giving these Chinese firms a competitive advantage in the domestic and global telecommunications markets.[129] Moreover, the NDRC appears to have imposed higher fines on alleged AML violations related to IP than other types of cases: typically, AML fines are a percentage of sales within China, but IP-related AML fines have been based on percentage of global sales revenue.[130]

The discrepancy between high fines for IP-related AML violations and low awards for IPR violations harms the ability of foreign companies to commercialize, license, or enforce patents or other IP rights in China.[131] According to a private database* of about 31,000 cases, average damages awarded in patent infringement cases in China range from $10,000 to $20,000.[132] These damages are considerably less than average damages in either Europe or the United States,† and "too low to compensate most innovations," ac-

* The Ciela database is maintained by Rouse, a global IP consultancy. The data come from judgments published by the major IP courts around China.

† By comparison, the overall median damages award in IP infringement cases in the United States between 1995 and 2013 was $5.5 million, and the median award in 2013 was $5.9 million. PricewaterhouseCoopers, "2014 Patent Litigation Study," July 2014, 6.

cording to Mark Cohen, senior counsel at the U.S. Patent and Trademark Office.[133] Fines lodged in China against foreign companies for alleged IP-related antitrust violations, on the other hand, average in the millions of dollars. As noted in the following text box, U.S. chipmaker Qualcomm was fined $975 million in February 2015 for its patent licensing practices—the highest antitrust penalty yet, registering more than 60,000 times the average damages awarded to foreign IP holders for patent infringement by Chinese companies.[134] In light of this disparity, prospective licensees in China are incentivized to continue infringing and risk an adverse Chinese judicial decision "while at the same time proactively launch[ing] a Chinese antimonopoly law case for even greater damages than royalties that are being asked of by the prospective licensor," casting further doubt on how much the Chinese government values a sound IP enforcement system, according to Mr. Cohen.[135]

**The NDRC's Qualcomm Decision: Chipping Away at Patent Protection and Licenses**

On November 25, 2013, Qualcomm—the world's largest smartphone chipmaker—disclosed it was being investigated under China's AML by the NDRC for price-related violations after several Chinese telecommunications firms alleged the company was overcharging Chinese mobile device makers on patent fees and boosting sales by bundling patent licenses with chip sales, among other alleged behaviors.[136] During the investigation, one AML regulator made several public remarks prejudging the outcome against Qualcomm, raising procedural irregularity concerns.[137]

On February 9, 2015, Qualcomm announced the NDRC's finding that the company exploited its dominant market position in several key telecommunications standard-essential patents (SEPs)—patents that are incorporated in setting technical standards, allowing for the interoperability of various technical devices—and chips to charge "unfairly high" royalty rates, tie wireless and nonwireless patents, and attach conditions to chip sales.[138] Qualcomm did not appeal the decision, and agreed to pay the $975 million fine levied by the NDRC, representing 3.7 percent of its total earnings in 2014 and 8 percent of its revenue from China sales in 2013.[139] In a press release, the company expressed disappointment with the results of the investigation.[140] The penalty levied on Qualcomm was the largest ever AML fine in China, though many telecommunications industry analysts described the fine as "modest," given the size of Qualcomm's China profits.[141]

In addition, the company agreed to implement a "rectification plan" to modify its business practices in China.[142] The key terms of the rectification plan include:

- Qualcomm will offer licenses to its current 3G and 4G Chinese SEPs separately from licenses to its other patents.

**The NDRC's Qualcomm Decision: Chipping Away at Patent Protection and Licenses—*Continued***

- For 3G devices using Qualcomm's Chinese SEPs, the company will charge 5 percent in royalties; for 4G devices, the company will charge royalties of 3.5 percent. Both will use a royalty base of 65 percent of the selling price of the device, a lower figure than the wholesale price of the device ordinarily used by Qualcomm.
- Qualcomm agreed not to condition the sale of baseband chips on the chip customer signing a license agreement with terms considered unreasonable by the NDRC.

Four months after Qualcomm's historic settlement, the company announced a new JV with China's largest chip maker, Semiconductor Manufacturing International Corporation (S.M.I.C.), Huawei Technologies, and a Belgian microelectronics research center, reportedly to focus on R&D of new integrated circuit technology "to boost China's semiconductor capabilities." [143] According to a statement released by the companies, S.M.I.C. will have the rights to license the IP created by the new JV.[144] In an interview with Reuters, Harvard Business School professor Willy Shih assesses Qualcomm is taking this step to be able to remain competitive in China. He explained, "The logic is if they help S.M.I.C. manufacture Qualcomm chips in China that improves their ability to sell those chips there." [145]

The significance of the NDRC's Qualcomm decision lies foremost in its application to holders of SEPs: under the NDRC's interpretation, holding an SEP constitutes having a dominant market position, so licensing of technologies through SEPs may constitute monopolistic conduct.[146] Therefore, all SEP holders are potentially at risk of being investigated for imposing unreasonable and unfair licensing terms. New regulations issued by the SAIC in April 2015 target non-pricing IP-related antitrust violations (see discussion of the rules below). Without its own formal rules for IP-related antitrust violations, the NDRC may rely on the Qualcomm decision as a model for its IP-related AML enforcement, posing danger for U.S. companies going forward, particularly in R&D-intensive industries.

The conflict between IPR protection and AML enforcement over technology licensing and standards setting in China could intensify starting in August 2015, when the SAIC's new regulations on the use of IPR to eliminate or restrict competition—China's first comprehensive guidelines to regulate IP practices under the AML—went into effect. (Neither MOFCOM nor the NDRC is required to follow the rules, but they are expected to do so.) * The rules intend to "protect fair market competition and encourage innovation" by

* Because the SAIC only has AML enforcement authority over conduct that is not related to pricing or to M&As, the rules do not address issues such as the charging of "unfairly high" royalties, which was the focus of the NDRC's Qualcomm investigation. Covington & Burling LLP, "China Issues Final IP/Antitrust Rules," April 21, 2015, 1–2.

prohibiting firms with a dominant* share of sales in a product or market from "abusing" their IPRs to eliminate or restrict competition.[147] The rules will regulate the following forms of abusive conduct, among others:

- Refusal to license IPRs that amount to "essential facilities";†
- Imposing certain exclusivity restrictions;
- Imposing unjustified tying and bundling requirements;
- Attaching unreasonable trading conditions to an IP agreement;
- Engaging in discriminatory conduct; and
- Engaging in practices that are inconsistent with "fair, reasonable, and non-discriminatory" (FRAND)‡ treatment in relation to the licensing of SEPs.[148]

These rules could have a significant impact on the licensing of IP in China, particularly by firms that account for a large share of sales in the technology market or hold patents that are essential to an industry standard—as several prominent U.S. tech firms do.[149] For one, the essential facilities doctrine—possibly the most controversial aspect of the regulations—states that refusal to license IP will violate the AML if the IPR holder is dominant, if the refusal to license "eliminate[s] or restrict[s] competition," and if the technology is "essential for production and business operations."§ [150]

Application of the essential facilities doctrine has faced serious criticism¶ in the U.S. Supreme Court because the doctrine fails to provide clear guidance as to what constitutes a facility, what makes a facility essential, and what constitutes a denial of access, while courts in Europe have applied this doctrine in a few exceptional and controversial decisions to facilities involving IP.[151] In the context of patent licensing, the essential facilities doctrine has never been used anywhere in the world.[152] In other countries, courts and agencies have found the application of the doctrine to

*According to the SAIC rules, the threshold for dominance is met for a company that (1) has a 50 percent or greater share of the relevant technology or product market, (2) together with one other company has a 66 percent or greater share of the market, or (3) together with two other companies has a 75 percent or greater share of the relevant market. Covington & Burling LLP, "China Issues Final IP/Antitrust Rules," April 21, 2015, 2.

†In general, the essential facilities doctrine prohibits anticompetitive conduct where a dominant firm prevents other competitors in the downstream market from acquiring and using certain essential facilities. The doctrine is traditionally applied in natural monopoly sectors such as railways, telecommunications, and electricity power generation and transmission. Michael Gu, "Brief Comments on China's First Anti-Monopoly Regulation in the IP Field," *AnJie Law Firm*, April 29, 2015, 3–4; Steve Harris, Mabel Lui, and Jingwen Zhu, "China's New Rules on Antitrust and Intellectual Property Intersected Issues," *Winston & Strawn LLP*, April 2015, 1.

‡In the Qualcomm case, the NDRC decision did not explain an accepted approach for calculating FRAND royalties.

§A dominant company is prohibited from refusing to license its IPRs on FRAND terms if (1) the IP is not "reasonably substitutable" and is essential for other business undertakings to compete in the relevant market; (2) refusal to license IP in the relevant market will adversely impact competition, innovation, and consumer interests; and (3) the obligation to license the IP will not cause unreasonable damage to the licensor. Michael Gu, "Brief Comments on China's First Anti-Monopoly Regulation in the IP Field," *AnJie Law Firm*, April 29, 2015, 4; Nicolas French et al., "A New Dawn? China Introduces First Antitrust Guidelines in Relation to Intellectual Property Rights," *Freshfields Bruckhaus Deringer*, April 2015, 3.

¶In *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), the Court rejected the notion that Verizon (then AT&T) was obligated by the 1996 Telecommunications Act to share infrastructure elements with competitors under antitrust law. U.S. Department of Justice, *Hearings on Single-Firm Conduct*, testimony of R. Hewitt Pate, July 18, 2006.

IPR may substantially harm incentives to innovate, and by extension, technological advancement.[153] While IP-specific guidance on the SAIC's AML enforcement is a positive development, the lack of specific and objective criteria leaves companies "unable to reliably predict whether refusing to grant a license in particular circumstances or on particular terms or conditions may be considered to be 'not justified,' and thus a violation of the AML, potentially resulting in an order compelling it to grant a license under terms and conditions imposed by the court or agency."[154]

Likewise, the SEP rules on standards setting represent a departure from international norms. Typically, a standards-setting organization coordinates across its members to disclose patents that may be essential to a standard, and requests the disclosing member to commit to license those patents that are essential on a royalty-free basis or on FRAND terms.[155] In the United States and the EU, participation in standards setting is voluntary, and SEP holders are free to exclude some or all of their technology from the standards-setting process.[156] In contrast, the SAIC's new IP rules could be interpreted to apply to the licensing practices of any holder of SEPs, regardless of whether the SEP holder participated in the standards-setting organization or committed to license its patents on FRAND terms at all.[157] In the Chinese legal context, these provisions could be used to extract or impose better terms for licensees under FRAND, creating significant uncertainty for licensing in China.[158] Consequently, FRAND developments in China potentially will have global impact on FRAND rates: if China sets lower rates on patent licensing under FRAND terms, other jurisdictions will be inclined to follow.[159] For example, based on the FRAND principle, Qualcomm will likely be expected to extend lower license rates to licenses in other jurisdictions, given its commitment to do so in China under its rectification plan.[160] The SAIC's IP rules will directly affect AML cases allegedly involving IP abuse—including the SAIC's ongoing investigations into Microsoft and Tetra Pak.

The U.S. government response to this growing threat to IPR holders in China primarily has consisted of multitiered engagement. The U.S. Federal Trade Commission (FTC) has been particularly active in engaging China's enforcement agencies in rectifying the practice of threatening AML investigations or penalties to procure cheaper licensing fees for domestic companies. FTC and U.S. Department of Justice (DOJ) officials have held several high-level meetings with Chinese antitrust officials since the two countries signed a memorandum of understanding on July 27, 2011, to promote communication and cooperation among the agencies.[161] FTC Chairwoman Edith Ramirez and FTC Commissioner Maureen Ohlhausen have delivered speeches expressing "serious concern" that China's approach to the AML suggests "an enforcement policy focused on reducing royalty payments for local implementers as a matter of industrial policy, rather than protecting competition and long-run consumer welfare."[162] Likewise, China's antitrust enforcement activities in IP-intensive industries have attracted a stream of criticism from U.S. officials. Jack Lew, U.S. Secretary of the Treasury, reportedly raised U.S. concerns to China's Vice Premier Wang Yang in September 2014.[163] In December 2014, White House

National Security Council Spokesman Patrick Ventrell said, "The United States government is concerned that China is using numerous mechanisms, including anti-monopoly law, to lower the value of foreign-owned patents and benefit Chinese firms employing foreign technology," and President Barack Obama raised this issue with Chinese President Xi Jinping when they met in Beijing in November 2014.[164]

U.S. officials have also expressed concerns about China's AML enforcement in bilateral fora. At the 2014 S&ED, China said it recognized that its competition law enforcement should be fair, objective, transparent, and nondiscriminatory, and committed to provide any party under investigation with information about concerns with the conduct in question, as well as an effective opportunity to present evidence in its defense.[165] At the 2014 Joint Commission on Commerce and Trade (JCCT), China committed to increase the ability of non-Chinese counsel to attend meetings with the AML enforcement agencies, and to make more transparent penalty procedures and competition-based remedies.[166] In 2015, the ability of non-Chinese counsel to attend meetings with Chinese enforcers has improved significantly, according to FTC Commissioner Ohlhausen, with no reports of exclusion; but it is unclear "whether this improvement is a result of the JCCT commitment or reflects a broader recognition by China's AML enforcers that participation of counsel is an important and beneficial element of best competition enforcement practices."[167] Building on China's 2014 JCCT commitments, at the 2015 S&ED Chinese officials provided clarity on the scope of jurisdiction in administrative appeals and confirmed that all parties to AML proceedings are entitled to seek administrative consideration in accordance with Chinese laws.[168] While administrative appeals are permissible under Chinese law, no foreign enterprise has appealed an enforcement decision.

## Reforms of China's Foreign Investment Framework

During the Third Plenum in November 2013, the CCP leadership indicated support for a wide range of structural and economic reforms that could potentially bring China's foreign investment rules closer to international standards. Incremental progress has been made in some of these areas within the boundaries of China's free trade zones (FTZs), while the forthcoming proposed foreign investment law (FIL) would lay the groundwork for streamlining government approvals and clarifying the regulatory environment. Overall, however, China's reform efforts have yet to substantially address core issues like foreign investment restrictions and preferential policies toward domestic industry.[169]

### *Draft Foreign Investment Law*

In January 2015, MOFCOM and the NDRC jointly circulated a draft of the new FIL, which will abolish the three existing laws governing foreign investment in China when it goes into effect.*

*As a procedural matter, the adoption of the draft FIL would require the approval of the National People's Congress. Given the priority of the draft FIL in relation to the other pending legislation as well as the legislative process of the National People's Congress, it is unlikely the FIL will come into effect until 2018. Anna Elshafei, "China's Draft Foreign Investment Law Could Be a Game Changer?" *Miller Canfield*, June 8, 2015.

Some elements of the draft FIL reflect key principles of the U.S. model Bilateral Investment Treaty (BIT), including the use of a negative list to identify instances in which FDI is to be treated differently than domestic investment.[170] In its current form, the draft FIL would significantly improve the legal and regulatory regime for a majority of foreign investment in China by eliminating approval requirements in unrestricted sectors.[171] Other aspects of the draft FIL, however, threaten to expand the scope of foreign investments subject to the increased discretionary power of approval authorities. For example, FIEs in restricted sectors will still need foreign investment approval and will continue to face numerous market access barriers such as foreign equity caps, geographic limitations, and local hiring minimums, as well as the current MOFCOM review and approval process.[172]

Under the draft FIL, the definition of a "foreign investor" has been expanded to include instances where the person or entity with ultimate "control"* over the company making the investment is foreign, even if the company itself is domestic.[173] For example, a domestic, Chinese-owned company structured to allow foreign strategic investors to operate in a sector with foreign equity restrictions—also known as a variable-interest entity (VIE)—would be considered a foreign investor. The scope of MOFCOM's approval authority will also be expanded to cover offshore investments—any transaction outside of China that results in the de facto control of a Chinese entity by an FIE will be considered a foreign investment—marking a significant shift from the current practice, where only onshore investments are subject to MOFCOM approval.[174] This shift in focus from foreign equity to foreign control will allow Chinese authorities to treat VIEs, a prevalent investment structure used by foreign investors to access restricted sectors of China's economy, with increased scrutiny and administrative discretion.[175] The VIE structure is also used by some prominent Chinese companies, like Internet giants Alibaba and Baidu, to access foreign capital by listing on foreign stock exchanges while operating in China.[176]

The draft FIL offers China's first formal regulation on VIE structures; currently, the legal standing of VIEs is ambiguous, causing uncertainty among foreign investors.† As for preexisting VIEs in restricted or prohibited industries, MOFCOM offers three possible approaches: (1) the VIE can continue to operate under the same structure if it notifies MOFCOM it is controlled by Chinese investors; (2) the VIE can continue to operate under the same structure if MOFCOM verifies its Chinese-controlled status at the entity's re-

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*The draft FIL defines "control" as follows: (1) directly or indirectly holding 50 percent or more of the shares, equity, property shares, voting rights, or other similar rights and interests of an enterprise; (2) despite holding less than 50 percent of the shares, equity, property shares, voting rights, or other similar rights and interests of an enterprise, (a) being entitled to directly or indirectly appoint at least half of the members of the board or a similar decision-making body, (b) being able to ensure that its nominees obtain at least half of the seats on the board or a similar decision-making body, or (c) being able to exert a material impact on the resolutions of the shareholders' meetings or the directors' meetings; or (3) being able to exert a decisive influence on such matters as the operations, finance, personnel, and technology of an enterprise through contracts, trusts, or other means. Joseph W.K. Chan, Ling Chen, and Calamus Huang, "China Set to Overhaul Foreign Investment Law," *Sidley Austin LLP*, February 26, 2015.

†For more information on the legal risks associated with VIEs, see Kevin Rosier, "The Risks of China's Internet Companies on U.S. Stock Exchanges," *U.S.-China Economic and Security Review Commission*, June 18, 2014.

quest; and (3) the VIE can apply to MOFCOM for foreign investment approval, and MOFCOM's approval decision would reference various factors, including the VIE's de facto controller in its approval decision.[177] As these guidelines suggest, preexisting VIEs in restricted or prohibited industries not controlled by Chinese investors are at risk of being denied investment approval or ultimately terminated.[178] For preexisting Chinese companies listed on U.S. stock exchanges utilizing the VIE structure, however, MOFCOM would have the discretion to determine de facto Chinese control and allow the entity to continue operations, even if the majority of shareholders are foreign.

*National Security Review*

Although the adoption of a negative list in the new FIL will likely be a positive development for FIEs, the national security review process proposed in the draft FIL and subsequently detailed in an April 2015 State Council announcement could worsen the foreign investment climate in China. Under the new negative list approach, the Foreign Investment Catalogue in use under the current regime will be abolished, though the negative list itself will still categorize sectors as either "prohibited" or "restricted."[179] Foreign investment in restricted sectors will be subject to a formal national security review, while foreign investors in unlisted industries will enjoy "pre-establishment national treatment": in lieu of applying for approval from MOFCOM as a prerequisite for market entry, FIEs would be able to establish businesses in China in the same way as domestic firms-namely, by applying directly to the SAIC.[180] Prior to the introduction of the review this year, foreign acquisitions of a controlling stake in Chinese companies in certain industries were subject to review under informal State Council regulations.[181]

The draft FIL broadens the scope of China's national security review to include "any foreign investment which damages or may damage the national security of China."[182] The review will be conducted by the NDRC and MOFCOM, and will take the following factors into consideration: (1) impact on national security, including China's capacity to provide essential goods and services to that end; (2) impact on the stability of the economy; (3) impact on basic social order; (4) impact on culture and social morality; (5) impact on Internet security; and (6) impact on sensitive technology for use in national defense.[183] Certain kinds of foreign investment, including investment into sensitive agricultural products, key natural resources and energy, strategic infrastructure, transport capabilities, technology and information technology, and investment near military facilities, will trigger review.[184] In effect, Chinese authorities will have broader discretion to review incoming foreign investments for perceived national security threats.

Three prominent U.S. business associations—the U.S. Chamber of Commerce, AmCham China, and AmCham in Shanghai—expressed their "deep concern" about the implications of China's "overly broad" definition of national security, which they describe as "heavily skewed in favor of protecting national interests that fall outside the widely accepted scope of essential national security concerns" and "likely to have a significant adverse impact on the flow

of foreign investment into China." [185] Specifically, China's national security definition includes economic security criteria that raise "fundamental questions about whether future commitments by China to open its markets to foreign investment will produce the intended results," and "may also be inconsistent with principles of non-discrimination, fairness, and openness that are embodied in a high-standard BIT," at the risk of undermining ongoing U.S.-China BIT negotiations.[186]

### *Free Trade Zones*

China's FTZs were designed to test reforms aimed at promoting further financial liberalization, reforming the foreign investment management system, and supporting outbound investment for potential application nationwide.* Some relevant financial reform measures have been carried out in the FTZs, but the promised liberalization has not materialized, much to the disappointment of foreign investors there.[187] One estimate shows that of the 12,600 companies registered in the Shanghai FTZ in its first year of operation, only 13.7 percent were FIEs.[188] Excluding Hong Kong and Taiwan companies, however, foreign companies comprised just 6 percent.[189]

The Shanghai FTZ, established in 2013, was specifically designed to test and accelerate national-level financial reforms including implementation of renminbi (RMB) capital account convertibility, market interest rates, and cross-border RMB handling. In 2015, Chinese Premier Li Keqiang approved the creation of three additional FTZs—in Guangdong, Tianjin, and Fujian—and subsequent expansion of the Shanghai FTZ to include Lujiazhai, the city's financial district.[190] According to Wang Shouwen, China's Assistant Minister of Commerce, the three new FTZs will play different strategic roles:

> *The one in Guangdong will focus on promoting the in-depth economic cooperation between the Chinese mainland, Hong Kong, and Macao, especially in the services sector. At the same time, the Guangdong FTZ shoulders the responsibility of upgrading China's manufacturing industry. The one in Tianjin will emphasize the joint development of Beijing, Tianjin, and Hebei. The one in Fujian deepens cross-Straits economic cooperation and will support the ["One Belt, One Road"] initiative.*[191]

All four FTZs adopted a unified negative list approach to foreign investment in April 2015.[192] Compared with the initial FTZ negative list promulgated in 2013, the 2015 FTZ negative list appears to feature many changes: the number of sectors restricted to foreign investment decreased from 190 in 2013 to 122 in 2015.[193] In practice, however, U.S. officials are concerned that China's negative list offer is not liberal enough to show a decisive commitment to "seriously and significantly" opening up to foreign investment.[194] Though the size of the FTZ negative list has been reduced, "many

*More detailed discussion of China's FTZs and related reforms can be found in U.S.-China Economic and Security Review Commission, *Monthly Analysis of U.S.-China Trade Data*, May 5, 2015.

industries and sectors have been merely re-grouped," according to the European Chamber.[195] U.S. business groups believe the revisions reflect "a streamlining of the negative list with other national regulations guiding foreign investment rather than a significant liberalization of the investment environment."[196] The 2015 FTZ negative list largely maintains restrictions in certain sectors in which the United States maintains a competitive advantage with China, including publishing, news, Internet content, films, law practices, and banking and asset management.[197] Foreign investment remains prohibited in sectors including rare earth mining, air traffic control system management, postal enterprises, and radio and television broadcasters.[198] Foreign investment in industries including oil and natural gas exploration and development, general-purpose airplane design, manufacturing, maintenance, and rare earth smelting will be restricted to JVs with Chinese companies.[199] In a positive development, foreign investors can now set up e-commerce companies* in all four FTZs.[200]

***U.S.-China Bilateral Investment Treaty***

At the June 2015 S&ED, the United States and China reaffirmed their commitment to prioritize negotiation of a high-standard, mutually beneficial BIT that "embodies the principles of non-discrimination, fairness, openness, and transparency."[201] In September 2015, ahead of President Xi's visit to Washington, DC, BIT negotiations entered their 21st round since commencing in 2008, and the two parties exchanged "improved" negative lists.[202] U.S. Trade Representative Michael Froman said China's newest negative list is "better than its original" and "represents serious effort by senior Chinese leaders," but that BIT negotiations are "a substantial distance from the kind of high standard agreement necessary to achieve our mutual objectives."[203] Proponents argue the BIT presents an opportunity to address and ban Chinese investment practices that are out of line with international business and legal standards, including unclear regulatory and legal enforcement, forced technology transfer, preferential policies for SOEs, and long-standing market access barriers.[204] Moreover, for China, the BIT could serve to "force domestic reform" of the investment framework by imposing "external obligations."[205] Critics of the BIT worry that, given the experience of China's WTO accession, even a high-standard agreement will not be meaningfully enforceable as it conflicts with Beijing's stated development path.[206]

## Implications for the United States

U.S. businesses play a critical role in China's economic development. As of 2014, cumulative U.S. FDI in China surpassed $65 billion, according to official U.S. data.[207] U.S. companies have not only contributed capital, but also advanced management practices, technological innovation, and access to global distribution channels

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*Excluding any value-added technology, media, and telecommunications business, which remains restricted and subject to at least 50 percent Chinese ownership requirement in accordance with the Ministry of Industry and Information Technology's Telecommunications Catalogue.

for Chinese products and services.[208] As recently as 2010, FIEs* employed 15.9 percent of China's urban workforce and accounted for about 26 percent of China's industrial output.[209] In 2014, according to official Chinese data, FIEs in China produced 45.9 percent of China's exports, down from 58.2 percent in 2006.[210] FIEs in China also accounted for 46.4 percent of Chinese imports, meaning they imported components into China for use in final products.[211]

Despite these achievements, foreign investors in China are still operating under a separate and less favorable set of rules designed to give domestic competitors an advantage. In addition to rising labor costs, surveyed foreign businesses also cite market access limitations and unclear and inconsistent enforcement of laws and regulations as the main challenges to establishing and operating businesses in China.[212] Recent threats of regulatory campaigns have also appeared to discriminate against FIEs in China, further contributing to the perception of a less welcoming operating environment.

While the laws governing foreign investment and forthcoming changes to the foreign investment framework are publicly touted as relaxing restrictions as China pursues its economic reform goals, in reality these policy changes expose U.S. companies in some of the United States' strongest export sectors—especially R&D-intensive industries—to increased regulatory scrutiny and administrative discretion. For example, although the number of sectors restricted or prohibited under China's updated Foreign Investment Catalogue has decreased, restrictions in industries that traditionally face heavy controls remain largely intact, while several new constraints (e.g., restrictions on foreign investment in auto manufacturing and medical institutions) have been introduced. Likewise, despite claiming to promote fair market competition, China's AML enforcement authorities appear to have used the threat of investigations to coerce FIEs into making concessions, giving Chinese competitors an advantage domestically and abroad. China's commitments in the draft FIL and FTZs to liberalize foreign investment rules by adopting a simplified negative list are overshadowed by the potentially discriminatory national security review procedures being tested for implementation nationwide, as well as by a new series of security-related laws.

In response to these threats, the U.S. government continues to raise concerns about China's investment restrictions and discriminatory policies at the highest levels, including in bilateral fora such as the JCCT and the S&ED.[213] Regarding China's AML enforcement, U.S. officials from the FTC and DOJ have consistently engaged in consultation, training, and exchanges with Chinese antitrust officials. One FTC commissioner testified that Chinese enforcers have responded seriously to U.S. government engagement, signaling improvement in their approach to AML enforcement—for example, at the 2014 JCCT, U.S. official engagement resulted in Chinese commitments of increased ability of counsel to attend meetings with the AML enforcement agencies, more transparent penalty

*Includes Sino-foreign contractual JVs, Sino-foreign equity JVs, and foreign-owned enterprises.

procedures, and competition-based remedies.[214] China's commitments at the JCCT and S&ED have not fundamentally allayed concerns about its competition policy enforcement, leading some experts to suggest that a number of current U.S. laws could be amended to better target procedural shortcomings and uneven enforcement.[215]

Foreign business groups have also been active in bringing attention to discriminatory policies and lobbying the Chinese government for much-needed regulatory clarity—for example, after detailed reports on China's competition policy were published by such groups, China's AML enforcement activity sharply declined. Experts at the Commission's January 2015 hearing testified that united efforts from government officials, business groups and industry associations, and expert practitioners are the most effective recourse for pushing China on liberalization.

Hopes for expanded bilateral investment continue to hinge on China's implementation of its reform commitments in a transparent and nondiscriminatory way. The U.S. government emphasizes the need for China to open new sectors to foreign investment, increase transparency, and improve the enforcement of existing laws to protect investors' rights.[216] If implemented, China's Third Plenum initiatives, FTZ reforms, and revised FIL could lead to improvements in the overall investment climate.

**Conclusions**

- U.S. companies continue to invest in China despite an increasing number of challenges on the ground and declining profitability. Chinese government measures, policies, and practices contributing to the deteriorating foreign investment climate include inconsistent and unclear legal and regulatory enforcement, increasing Chinese protectionism, and other preferential policies benefitting domestic companies.
- Across industries, market access barriers continue to top the list of Chinese government measures that limit the ability and willingness of U.S. companies to invest in China. As a means to protect its domestic companies and industries, China restricts foreign investment in sectors in which the United States maintains competitive advantage, including research and development-intensive and value-added information services sectors.
- Fluctuations in China's foreign investment restrictions reflect a pattern whereby the government welcomes foreign direct investment into sectors deemed strategic for China's national economic development in order to extract technology, intellectual property, and know-how from foreign firms. However, after domestic industry is deemed sufficiently developed, policies welcoming investment are gradually withdrawn and new policies restricting investment are put in place to free up market space for domestic firms and push out foreign firms.
- China's Anti-Monopoly Law enforcement agencies—the Ministry of Commerce, the National Development and Reform Commission, and the State Administration of Industry and Commerce—have failed to treat identical or similar violations of the law

equally, resulting in more leniency toward state-owned enterprises, more rigorous enforcement against foreign companies, and substantially varied penalties imposed on companies in similar circumstances, regardless of nationality of the controlling shareholder. The enforcement practices of the National Development and Reform Commission in particular are lacking in transparency, consistency, and fairness.

- The imbalance in expectations between domestic and foreign firms for reporting mergers and acquisitions to China's Ministry of Commerce in accordance with the Anti-Monopoly Law puts foreign-invested enterprises at a disadvantage by unfairly and disproportionately exposing them to increased scrutiny, regulatory uncertainty, approval delays, and associated costs.
- Chinese Anti-Monopoly Law enforcers' legal interpretations of monopolistic abuse of intellectual property by "dominant" firms could have a significant impact on the licensing of intellectual property in China, particularly by firms that account for a large share of sales in the technology market or hold patents that are essential to an industry standard—as several prominent U.S. tech firms do.
- China's commitments to seriously and significantly open up to foreign investment are overshadowed by new measures that reinforce longstanding market access barriers and discriminatory treatment toward foreign investors.
- Some aspects of China's proposed foreign investment law—such as streamlined approval processes and the negative list approach—are encouraging, and signal a move toward fulfilling economic reform goals set forth in the Third Plenum and converging with international investment practices. Yet, some troubling provisions remain, including a broadly discretionary and expanded national security review mechanism and targeting of companies, commonly foreign, using particular investment structures to access the market.

**Addendum I: M&As Rejected or Conditionally Approved by MOFCOM***

| **Date Announced** | **Industry** | **Parties** | **Remedy** | **Case Duration** |
|---|---|---|---|---|
| November 2008 | Beverage Manufacturing | InBev, Anheuser-Busch | Conditionally approved | 70 days |
| *March 2009* | *Beverage Manufacturing* | *Coca-Cola, Huiyuan* | *Rejected: MOFCOM asserted the proposed acquisition would enable Coca-Cola to leverage its dominant position in the carbonated soft drinks market to dominate the juice market, raising entry barriers and limiting the ability of small- and medium-sized juice companies to compete.* | *182 days* |
| April 2009 | Chemical Manufacturing | Mitsubishi Rayon, Lucite | Conditionally approved | 124 days |
| September 2009 | Auto/Equipment Manufacturing | General Motors, Delphi | Conditionally approved | 42 days |
| September 2009 | Pharmaceuticals | Pfizer, Wyeth | Conditionally approved | 113 days |
| October 2009 | Battery Manufacturing | Panasonic, Sanyo | Conditionally approved | 283 days |
| August 2010 | Healthcare | Novartis, Alcon | Conditionally approved | 116 days |
| June 2011 | Chemicals/ Fertilizer | Uralkali, Silvinit | Conditionally approved | 81 days |
| October 2011 | Textile Machine Manufacturing/ Private Equity | Alpha V, Savio | Conditionally approved | 110 days |
| *November 2011* | *Energy* | *General Electric, Shenhua (formation of a JV)* | *Conditionally approved* | *212 days* |
| December 2011 | Computing Components | Seagate, Samsung | Conditionally approved | 208 days |

*Italicized rows denote a proposed transaction involving both domestic and foreign-invested entities; all other listed transactions involve only foreign-invested entities.

**Addendum I: M&As Rejected or Conditionally Approved by MOFCOM*—*Continued***

| Date Announced | Industry | Parties | Remedy | Case Duration |
|---|---|---|---|---|
| *February 2012* | *Chemical Manufacturing* | *Henkel Hong Kong, Tiande (formation of a JV)* | *Conditionally approved* | *186 days* |
| March 2012 | Electronics Components | Western Digital, Hitachi | Conditionally approved | 336 days |
| May 2012 | Mobile Phone Manufacturing | Google, Motorola Mobility | Conditionally approved | 233 days |
| April 2013 | Natural Resources/Mining | Glencore, Xstrata | Conditionally approved | 381 days |
| April 2013 | Agricultural Products | Marubeni, Gavilon | Conditionally approved | 308 days |
| August 2013 | Medical Devices | Baxter, Gambro | Conditionally approved | 221 days |
| August 2013 | Electronics Components | Mediatek, Mstar | Conditionally approved | 417 days |
| January 2014 | Biotechnology | Termo Fisher, Life Technologies | Conditionally approved | 196 days |
| April 2014 | IT/Software/Mobile Equipment Manufacturing | Microsoft, Nokia | Conditionally approved | 208 days |
| May 2014 | Mobile Device Manufacturing | Merck kGaA, AZ Electronic Materials | Conditionally approved | 106 days |
| June 2014 | Transportation Shipping | Maersk, MSC, CMA CGM | Rejected: MOFCOM rejected plans by three leading European shipping companies to form a shipping alliance that would allow the companies to share ships and port facilities, noting the three companies already held a 46.7 percent market share in the Asia-Europe container shipping line market. | 273 days |

*Italicized rows denote a proposed transaction involving both domestic and foreign-invested entities; all other listed transactions involve only foreign-invested entities.

**Addendum I: M&As Rejected or Conditionally Approved by MOFCOM*—*Continued***

| **Date Announced** | **Industry** | **Parties** | **Remedy** | **Case Duration** |
|---|---|---|---|---|
| *July 2014* | *Battery Manufacturing* | *Primearth EV Energy, Toyota Motor China Investment, Toyota Tsusho, Hunan Corun New Energy, Changshu Sinogy Venture Capital (formation of a JV)* | *Conditionally approved* | *184 days* |

*Italicized rows denote a proposed transaction involving both domestic and foreign-invested entities; all other listed transactions involve only foreign-invested entities.

*Source:* Adapted from US-China Business Council, "Update: Competition Policy & Enforcement in China," May 2015, 11–17.

**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015** *

| Completed Cases<br>[36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| March 2010 | Rice Noodle Manufacturing | Guangxi Price Bureau | Juezhihe, Xianyige, Liuzhou Brothers, Yongcai, and other rice noodle manufacturers | Starting in 2010, 18 rice noodle manufacturers colluded to discuss profit sharing and business integration and to set market prices in violation of the Price Law and the AML. The bureau fined the three leading companies $14,648 apiece, and ordered fines ranging from $4,394 to $11,718 for others according to their behaviors. |
| August 2010 | Paper Making | Zhejiang Price Bureau | Fuyang Paper Manufacturing Industry Association | In 2010, the association held meetings with member companies to discuss the sales price for white paperboard. The bureau ruled this behavior violated the Price Law and the AML, and fined the association $73,437. |
| November 2010 | Household Products | Hubei Price Bureau | Wuchang Salt Company | In July and August 2010, the company required distributors to purchase both salt and Huolierba detergent powder. The bureau announced the company had violated two articles of the AML, but the company had voluntarily returned illegal revenue to distributors. |

* Italicized cells indicate the involvement of a foreign-invested enterprise.

**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015 *—*Continued***

| **Completed Cases**<br>[36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| May 2011 | Household Products | Shanghai/NDRC | *Unilever* | In March 2011, Unilever released information to the media that it might raise detergent and soap prices because of raw materials costs, causing "panic buying" in customers. The NDRC ruled the behavior violated the Price Law, ordered Unilever to cancel the price hike, and fined the group $307,978. |
| November 2011 | Pharmaceuticals | Shandong/NDRC | Weifang Shuntong, Huaxin | The NDRC found the companies had signed an exclusive distribution agreement with the only two domestic producers of a key raw material commonly used in high blood pressure treatments, thus eliminating competition. The NDRC found these behaviors violated the AML and the Price Law, and fined Weifang Shuntong $1.1 million and Huaxin $23,505 under the AML. |
| February 2012 | Chemicals | Hubei/NDRC | Hubei Yihua Group | The NDRC and its Hubei branch found Yihua had worked with other companies to fix prices, and subsequently imposed those prices on its customers, causing the price of sodium hydrosulphite to increase by 300 percent in 2011. The authorities fined Yihua $1.6 million for violation of the AML. |

| March 2012 | Sea Sand | Guangdong Price Bureau | Guangdong Sea Sand Association and its members | Several companies took steps to set and manipulate resource fees for mining sea sand under the umbrella of the association in violation of the AML. Three members of the association were collectively fined $120,565, and others were issued warnings. |
|---|---|---|---|---|
| January 2013 | LCD Panels | Nationwide | *Samsung, LG, Chimei, AUO, Chunghwa Picture Tubes (CPT), HannStar Display Corporation* | The NDRC found these six foreign LCD manufacturers met repeatedly between 2001 and 2006 to exchange information on the LCD panel market and set or manipulate LCD panel prices in China in violation of the Price Law. The NDRC ordered the parties to return the overcharged funds to Chinese television enterprises ($27.6 million), confiscated other illegal gains ($5.9 million), and fined the companies $23.1 million. The NDRC also ordered the companies to take other corrective measures. |
| February 2013 | Liquor (*baijiu*) | Guizhou Price Bureau | Kweichow Moutai Group | The bureau found Moutai had sought to fix the minimum resale price to third-party distributors since 2012, taking punitive measures against those who did not implement the price, in violation of the AML as a resale price maintenance agreement. The bureau fined the company $39.6 million, or 1 percent of the relevant sales revenue in the previous year. |

* Italicized cells indicate the involvement of a foreign-invested enterprise.

**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015 [*]—*Continued***

| Completed Cases [36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| February 2013 | Liquor (*baijiu*) | Sichuan DRC | Wuliangye Group | The Sichuan DRC found Wuliangye signed agreements with over 3,200 dealers from 2009 to 2013 to limit the lowest resale price for its products, taking punitive measures against those who did not implement the price, in violation of the AML. The DRC fined Wuliangye $32.4 million, or 1 percent of the relevant sales revenue in the previous year. |
| July 2013 | Insurance | Xinjiang | Xinjiang Insurance Industry Association and 15 branches of national property insurance group companies | Six insurance companies were punished for horizontal monopoly agreements; it is unclear whether the other nine companies have yet been punished. |
| August 2013 | Gold Jewelry | Shanghai Price Bureau | Shanghai Laofengxiang, Yuyan Plaza | The Shanghai Price Bureau ruled that the company and other gold jewelry stores sought to set retail prices under the umbrella of the Shanghai Gold & Jewelry Trade Association in violation of the AML. The bureau fined the association $81,743 and the five stores a total of $1.6 million, or 1 percent of their previous year's sales. |

| August 2013 | Concrete Manufacturing | Jiangsu Price Bureau | Nanjing Concrete Industry Association and 37 concrete manufacturers | After an August 2013 investigation, the bureau found the association and 37 companies engaged in anticompetitive pricing violations, and imposed a collective $6.2 million fine on all parties. The association and one other company refused to follow the administrative decision, and were ordered by the Nanjing Intermediate Court on December 8, 2014, to pay the fine. Four other firms filed administrative lawsuits against the bureau's decision, but were rejected. |
|---|---|---|---|---|
| August 2013 | Milk Powder | Nationwide | *Biostime, Mead Johnson Nutrition, Dumex, Abbott, Friesland Campina, Wyeth, Fonterra, Beingmate, Meiji* | The NDRC found nine milk powder companies guilty of fixing resale prices for distributors and retailers in violation of the AML. The NDRC fined six of these producers a total of $109.3 million, with fines ranging from 3 to 6 percent of the previous year's revenue. |
| September 2013 | Tourism | Hainan Price Bureau | Sanya Platinum Crystal Crafts, Crystal Source, Good Royal Crystal | The bureau ruled that these three companies formed a cartel, holding coordination meetings and signing a formal agreement in June 2012 to fix prices, commission rates, and market share for crystal products in violation of the AML. Sanya and Crystal Source were fined $588,134 (4 percent of the previous year's revenue) and $220,550 (2 percent of the previous year's revenue), respectively, for monopoly agreement, with additional fines for concealing, transferring, or destroying financial evidence. Good Royal was exempt from punishment for cooperating with authorities. |

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**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015*—*Continued***

| **Completed Cases**<br>[36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| September 2013 | River Sand | Guangdong Price Bureau | Two domestic river sand companies | The two companies, owned by the same individual, held a 75 percent share of the local sand mining and processing market. The companies were accused of hoarding large amounts of sand, leading to a price increase of up to 54.5 percent over two years. The bureau fined the companies 2 percent of their previous year's sales revenue (approximately $86,000). |
| September 2013 | Milk Processing | Qinghai Price Bureau | Qinghai pasteurized milk producer | The bureau found the company to have a monopoly in the local market, which it exploited to increase the sales price by 267 percent, constituting excessive pricing. The company voluntarily committed to correct the pricing and not raise prices for four months; the bureau subsequently terminated the investigation. |
| September 2013 | Tourism | Hainan, Yunnan Price Bureaus | Tourist shops selling crystal and spirulina products including Sanya Dijia Trade and Development Company, Sanya Zhongyu Crystal Company, and Lijiang Kangnuo Biological Development Company [1] | Tourist-oriented shops selling crystal products and spirulina were accused of using discounts on artificially inflated prices for these products to lure in customers. Local pricing agencies found these practices violated the Price Law, and fined each shop $49,011. |

| September 2013 | Tourism | Yunnan DRC | Eight travel agencies in Yunnan, including the Lijiang branch of Ctrip, under the guidance of the Lijiang Tourism Association Travel Agency Division | The Yunnan DRC ruled that eight travel agencies, operating under the umbrella of the Lijiang Tourism Association's Travel Agency Division, signed agreements in 2008 and 2010 to set prices for tour groups, sharing $37.1 million in profits over two years, in violation of the AML as a price monopoly agreement. The agency was fined $81,685, and the travel agencies were collectively fined $547,291, or 5 percent of the previous year's revenue. |
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| September 2013 | Tourism | Hainan Price Bureau | Travel agencies in Hainan, including Hainan Haikou Civil Tourism Agency, the Yangguang Chunjing Travel A5 Tian Tour Group, and the Hainan Tongxing Tianxia Travel Agency | The bureau ruled that several travel agencies used bait-and-switch tactics to lure customers, pricing tours at or below cost to attract tourists and then charging high commissions from shopping activities organized by the tour groups. The bureau ruled that such behavior violates the Price Law, and fined each agency $49,011. |
| December 2013 | Insurance | Hunan Price Bureau | Hunan Loudi City Insurance Industry Association and 12 domestic insurance-related companies | The association organized companies to set prices for new car insurance discount rates, divided up the market, and engaged in other anticompetitive behaviors in violation of the AML. The bureau fined the association and six of the companies $361,746. The other five companies were exempt from penalties for cooperating with authorities. |

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**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015*—*Continued***

| **Completed Cases**<br>[36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| February 2014 | Banking | Nationwide | Domestic commercial banks (unnamed) | Chinese banks were accused of imposing arbitrary charges and fees on customers. In February 2014, the NDRC announced it had ordered 64 branches of different banks to return $66.5 million in fees from those charges, and imposed fines of $67.7 million. |
| May 2014 | Telecommunications | Nationwide | *InterDigital* | The company was accused of abuse of market dominance, charging discriminative high-price patent license fees for China's communications equipment manufacturers, and issuing bundled licenses for nonstandard essential patents and standard essential patents. In June 2014, the NDRC announced the investigation was suspended. |
| May 2014 | Vision Care | Nationwide | *Essilor, Zeiss, Nikon, Bausch & Lomb, Johnson & Johnson, Hoya, Weicon* | Seven manufacturers of eyeglasses and contact lenses were accused of setting minimum resale prices and running promotions that effectively served as resale price maintenance arrangements. The NDRC found their actions in violation of the AML and fined five manufacturers a total of more than $3 million, with rates of either 1 or 2 percent of the previous year's sales. |

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| July 2014 | Brick Manufacturing | Hainan | Five domestic manufacturers of aerated bricks | In October 2012, five manufacturers of bricks with holes to allow airflow established without authorization an industry association to harmonize sales price; supervision and control; and statistics for production, sales, and shipments. The five companies agreed upon and coordinated price increases and signed monopoly agreements to divide sales. Three companies were fined $85,879, or 1 percent of the previous year's sales, and the others were exempted for cooperation. |
| August 2014 | Automotive | Nationwide | *Hitachi, Denso, Aisan, Mitsubishi Electric, Mitsuba, Yazaki, Furukawa Electric, and Sumitomo Electric; (separate case) Nachi-Fujikoshi, NSK, JTEKT, and NTN* | The NDRC announced that eight auto parts manufacturers and four bearings manufacturers had held frequent consultations to set and influence pricing of vehicles, auto parts, and bearings. Fines for companies that did not cooperate were $135.1 million for the seven auto parts companies and $65.5 million for three bearings companies, ranging between 4 and 8 percent of each company's previous year's sales. |
| August 2014 | Automotive | Hubei Price Bureau | *Four Mercedes-Benz dealerships* | The bureau announced that four dealerships had overcharged customers for the predelivery inspection of purchased automobiles, and had colluded to set prices. The bureau fined the dealerships a collective total of $264,666. |

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**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015 [*]—*Continued***

| **Completed Cases** [36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| September 2014 | Insurance | Zhejiang | Zhejiang Insurance Industry Association and 23 property insurance companies | The NDRC announced the association and 23 companies held frequent consultations to set and influence discount rates of new vehicles and unified commercial commissions for auto insurance agencies in violation of the AML, fining the association $81,457 and the companies a total of $18 million, or 1 percent of the previous year's sales revenue. Fines were waived or reduced for three companies that cooperated with investigating authorities. |
| September 2014 | Cement | Jilin Price Bureau | Three domestic cement companies: Yatai, Northern, and Jidong | The bureau announced the companies had held several consultations to agree to set cement price and implementation policies in violation of the AML, and fined Yatai and Jidong 2 percent of their 2012 sales revenues, and fined Northern 1 percent of its 2012 sales revenue. Collectively, fines totaled $18,636. |

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| September 2014 | Automotive | Shanghai Price Bureau | *Chrysler China Automotive Sales Company; (separate case) three Chrysler Shanghai dealerships* | The bureau found Chrysler and its three dealerships engaged in concluding and implementing price monopoly agreements by signing dealership agreements containing resale price maintenance terms. Chrysler was fined approximately $5 million; the three dealers were collectively fined more than $300,000. |
| September 2014 | Automotive | Hubei Price Bureau | *FAW-Audi Sales, and ten Audi dealers in Hubei* | The bureau announced the company and ten dealers had reached monopoly agreements to set and influence vehicle sale and maintenance prices in violation of the AML. The bureau fined FAW-Audi Sales $40.4 million, or 6 percent of its previous year's sales revenue, and fined eight of the dealers a total of $4.9 million: seven were fined 1 to 2 percent of the previous year's sales revenue; one was fined 0.5 percent of its previous year's sales revenue; and two were exempted from penalties. |
| February 2015 | Telecommunications | Nationwide | *Qualcomm* | The NDRC fined Qualcomm $971.7 million, or 8 percent of its sales revenue in China in 2013, for violation of the AML. The NDRC argued Qualcomm holds a dominant market position in several key telecommunications standard-essential patents and in chips, and had used that position to charge high royalty rates, tie wireless and nonwireless patents, and attach conditions to chip sales. |

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**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015 [*]—*Continued***

| **Completed Cases**<br>[36 known cases involving approximately 269 entities or associations, of which 71 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| April 2015 | Automotive | Jiangsu Price Bureau | *Mercedes-Benz and its dealers in Nanjing, Wuxi, and Suzhou* | The bureau announced Mercedes-Benz reached a monopoly agreement with its dealers in Jiangsu Province by enforcing minimum prices for dealers to charge for its products, and implemented fixed-price agreements for part of the components in violation of the AML. The bureau fined Mercedes-Benz $56.4 million, or 1 percent of its sales revenue of the previous year. The dealers were fined $1.27 million in total. |
| September 2015 | Automotive | Guangdong Price Bureau | *Dongfeng Nissan and 17 of its car dealerships in Guangzhou* | The bureau announced in September that Dongfeng Nissan and its 17 dealers in Guangdong Province carried out price control through its sales and service agreements. The bureau fined Dongfeng Nissan $19.7 billion (RMB 123.3 billion), and collectively fined the dealerships $3.1 billion (RMB 19.1 billion). |

| **Ongoing Cases**<br>[nine known cases involving at least 70 entities or associations, of which at least 12 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| November 2011 | Telecommunications | n/a | China Mobile, China Unicom | Alleged abuse of market dominance through price discrimination |

| August 2012 | E-Commerce | n/a | 360 Buy, Gome, Suning | Alleged illegal and fraudulent behavior while engaging in low-cost competition |
|---|---|---|---|---|
| March 2013 | Cement | n/a | Cement companies nationwide | Alleged supply restrictions |
| July 2013 | Pharmaceuticals | n/a | *GlaxoSmithKline, Merck, Astellas, Novartis, Beohringer Ingelheim, Baxter International, Fresenius, UCB, and others* | Alleged unfair import pricing (33 companies); internal cost structure (transfer pricing) (27 companies) |
| August 2013 | Automobile | n/a | *Imported cars and domestic auto JVs (no specific companies named)* | Alleged excessive pricing |
| April 2014 | Pharmaceuticals | n/a | Nine unnamed pharmaceutical companies across six provinces, including Jiangsu, Anhui, Zhejiang, Hebei, Liaoning, and Shanghai | Alleged monopolistic pricing practices |
| July 2014 | Automobile | n/a | *Luxury car makers, including Mercedes-Benz, Audi, Toyota, Land Rover, and others* | Alleged abuse of dominant market position; imposition of horizontal and vertical restraints on competition (fines not yet announced) |
| August 2014 | Express Delivery | n/a | Domestic express delivery companies in Chongqing and Xiangtan, Hunan | Alleged illegal pricing behavior, including collusion |

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**Addendum II: Pricing Investigations Conducted by the NDRC and Provincial Development and Reform Commissions, 2008–2015 *—*Continued***

| **Ongoing Cases** [nine known cases involving at least 70 entities or associations, of which at least 12 are foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| August 2014 | Real Estate | n/a | Real estate brokers in Tianjin (no specific companies named) | Alleged monopolistic pricing practices |

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[1] At least three individual companies were named in the penalty decision, but the total number of shops operating in violation of the AML was not published. China's National Development and Reform Commission, "Case Involving a Group Illegally Manipulating Market Prices in Tourism Thoroughly Investigated," September 29, 2013. Staff translation.

*Source:* US-China Business Council, "Update: Competition Policy & Enforcement in China," May 2015, 19–26; Zhang Xingxiang, "China's Anti-Monopoly Law Enforcement: A Quest for Transparency, Consistency and Fairness," *Indiana University Research Center for Chinese Politics and Business* Working Paper #37, April 2015, Appendix 1, 1–5; Christoph Barth and Qiuying Zheng, "NDRC Issues Decision in Landmark Case against Qualcomm and Imposes Record Fine of RMB 6.088 Billion," *Linklaters LLP*, February 2015; China's National Development and Reform Commission, *Case Involving a Group Illegally Manipulating Market Prices in Tourism Thoroughly Investigated*, September 29, 2013. Staff translation; Xinhuanet, "Auto Industry Anti-Monopoly Guide Draft To Be Finished This Year," September 17, 2015. Staff translation.

**Addendum III: Monopoly Investigations Conducted by the SAIC and its Provincial Branches, 2008–Present***

| **Completed Cases**<br>[21 known cases involving approximately 78 enterprises or associations, none of which is foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| August 2010 | Concrete | Jiangsu Administration of Industry and Commerce (AIC) | Lianyungang Construction Material and Machinery Association and 16 member companies | The Jiangsu AIC found the association and 16 member companies signed an illegal monopoly agreement prohibiting all involved from independently signing contracts with buyers. The AIC confiscated illegal profits of more than $20,046, and fined five participants in the cartel a combined total of $77,950. |
| April 2011 | Liquefied Petroleum Gas (LPG) | Jiangxi AIC | Taihe County Huawei LPG Station and six other gas companies | The Jiangxi AIC found the LPG Station signed an agreement with six other LPG companies in 2008 to monopolize and divide up the market in violation of the AML, and confiscated illegal gains of $31,665. The AIC also fined Taihe County Huawei LPG Station $20,063. |
| January 2012 | Secondhand Automobiles | Henan/SAIC | 11 secondhand car dealerships in Anyang, Henan | The SAIC ruled that the group of three secondhand auto dealerships formed a cartel and signed an agreement to set a uniform price and market share in 2007. By 2009, the cartel expanded to include 11 dealerships in violation of the AML. The SAIC confiscated $232,691 in illegal profits and imposed a collective fine of $42,005 on the participants. |

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**Addendum III: Monopoly Investigations Conducted by the SAIC and its Provincial Branches, 2008–Present [*]—*Continued***

| Completed Cases [21 known cases involving approximately 78 enterprises or associations, none of which is foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| August 2012 | Cement | Liaoning AIC | Liaoning Construction Material Industry Association and 12 member companies | The association's cement committee and 12 member companies signed agreements in 2010 to monopolize the market, control production, and set market share. The Liaoning AIC ruled their behavior constituted an illegal monopoly agreement under the AML and fined the association and the 12 member companies $2.6 million collectively. |
| November 2012 | Insurance | Hunan/SAIC | Yongzhou Insurance Association and ten member companies | The SAIC found the association and 12 insurance companies signed an agreement in 2011 establishing a new car insurance service center, which served as a window for setting up consumer purchases of new car insurance. The SAIC judged the agreement to be an illegal monopoly agreement, and fined the ten insurance companies $64,194, and the 12 member companies a total of $155,990. |
| December 2012 | Insurance | Hunan/SAIC | Zhangjiajie Insurance Association and eight member companies | The SAIC found the association and eight insurance companies signed agreements in 2010 to establish a new car insurance service center as a window for consumer purchases of new car insurance, constituting an illegal monopoly agreement. The SAIC fined the association $64,192. |

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| December 2012 | Insurance | Hunan/SAIC | Changde Insurance Association and nine member companies | The SAIC ruled the association and nine insurance companies signed agreements in 2006 to establish a new car insurance service center as a window for consumer purchase of new car insurance, constituting an illegal monopoly agreement. The association was fined $72,216. |
| December 2012 | Insurance | Hunan/SAIC | Chenzhou Insurance Association and 14 member companies | The SAIC found the association and ten insurance companies signed an agreement in 2007 to establish a new car insurance service center as a window for consumer purchases of new car insurance. The SAIC fined the association $72,216. |
| December 2012 | Concrete | Zhejiang AIC | Jiangshan Tiger Product Concrete, Jiangshan Yongcheng Concrete, and Jiangshan Hengjiang Product Concrete | The Zhejiang AIC ruled the three companies made an oral agreement in 2009 to divide up the city's concrete market, set prices, and eliminate competition, constituting an illegal monopoly agreement. The AIC fined the three companies a total of $189,367. |
| March 2013 | Construction Equipment | Zhejiang AIC | Cixi Construction and Engineering Testing Association, Cixi Building and Engineering Quality Supervision Station Energy Office, and three companies | The Zhejiang AIC found the parties signed an agreement in 2010 to divide market share and set ground rules for competition. The AIC suspended the investigation in 2012 based on submissions from the parties, and closed the investigation in March 2013 without punishments. |

* Italicized cells indicate the involvement of a foreign-invested enterprise.

**Addendum III: Monopoly Investigations Conducted by the SAIC and its Provincial Branches, 2008–Present*—*Continued***

| Completed Cases [21 known cases involving approximately 78 enterprises or associations, none of which is foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| March 2013 | Bricks/Ceramics | Sichuan AIC | Yibin Building Material Industry Association Brick Committee, three of its member companies, and one individual | The Sichuan AIC ruled the three member companies of the committee signed a series of agreements in 2009 designed to limit the output of bricks in the market and control market share, constituting an illegal monopoly agreement. The companies were fined a total of $161,093, and an involved individual was fined $9,666. |
| April 2013 | Tourism | Yunnan AIC | Xishuangbanna Tourism Association, Xishuangbanna Travel Agency Association | The Yunnan AIC found the tourism association launched a platform in 2003 and convinced more than 80 other groups to sign on, effectively promoting specific tours to specific stops with punitive actions for those who deviated. Concurrently, the travel agency association and 24 travel agencies signed agreements to set prices and itineraries for travel. The AIC fined each association $64,859. |
| July 2013 | Civilian Blasting | Guizhou/Anshun AIC | Qianzhong Civilian Blasting Equipment Operating Company | The AIC found a local subsidiary of the company was guilty of abuse of market dominance and excessive prices, and fined the company $20,715. |

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| December 2013 | Water Supply Engineering | Guangdong AIC | Huizhou Daya Bay Yiyuan Purified Water | The AIC found Yiyuan used its strong market position to require local real estate companies to sign agreements bundling water supply with other services, constituting a violation of the AML. The AIC required the company to halt operations, turn over illegal gains of $142,056, and pay a fine of 2 percent of its previous year's revenue, or $396,434. |
| June 2014 | Sports and Entertainment | Beijing AIC | Shankai Sports International | The company—the authorized vendor of package tours to the 2014 FIFA World Cup in Brazil for China, Hong Kong, and Macau—was accused of bundling various products and services, and requiring customers to purchase set bundles, in violation of a March 2011 agreement with Beijing China Travel Service Company. The Beijing AIC suspended the investigation in June 2014, stating that Shankai admitted its violations and took undisclosed steps to address concerns. In January 2015, the SAIC announced its decision to terminate the investigation. |
| July 2014 | Fireworks | Inner Mongolia AIC | Six fireworks companies in Chifeng, Inner Mongolia | The six companies that were designated locally as the sole wholesalers for various products were accused of abusing their dominant market position by requiring distributors to apply for fireworks purchases, among other requirements, or see their purchasing quotas cut. Four of the companies also signed an illegal monopoly agreement. The AIC fined the six companies $94,580 total. |

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**Addendum III: Monopoly Investigations Conducted by the SAIC and its Provincial Branches, 2008–Present [*]—*Continued***

| **Completed Cases**<br>[21 known cases involving approximately 78 enterprises or associations, none of which is foreign] | | | | |
|---|---|---|---|---|
| **Date Announced** | **Industry** | **Location/Agency** | **Companies Involved** | **Description** |
| October 2014 | Sand and Gravel Mining | Chongqing AIC | Four quarry operators in Wuxi County, Chongqing | The quarry operators were accused of setting a verbal monopoly agreement in order to divide the sand and gravel sales required to construct the local portion of the Fengxi Highway. The AIC imposed fines of $65,440 on the operators. |
| October 2014 | Tobacco | Jiangsu AIC | Pizhou Subsidiary of Xuzhou Tobacco Company | The head of the subsidiary was accused of abusing the company's dominant market position to unfairly determine supply allotted to different retailers without reasonable cause. The AIC fined the individual $281,394, or 1 percent of the sales revenue made from selling cigarettes under limited supply conditions. |
| November 2014 | Natural Gas | Chongqing AIC | Chongqing Gas Group | The company overcharged its customers for natural gas using fee rates that were inflated. The AIC ruled the activity constituted abuse of market dominance in violation of the AML. Because the company cooperated, the AIC lightened its punishment, resulting in a fine of $291,500, or 1 percent of its 2010 sales revenue. |

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| December 2014 | Concrete | Zhejiang AIC | Zhejiang Shangyu Concrete Association and eight member companies | The association and eight member companies were determined to be using monopoly agreements to divide local market share, in violation of the AML. The AIC fined the association $1,611 and imposed fines ranging from $1,611 to $64,477 on the eight firms. |
| February 2015 | Water Supply | Hainan AIC | Hainan Dongfang Water Company | The company was accused of abusing its market dominance to impose conditions on new users when providing water supplying services, in violation of the AML. The AIC confiscated illegal gains of $6,148 and fined the company $94,683, or 2 percent of its sales revenue in the previous year. |
| July 2013 | Food and Beverage Packaging | n/a | *Tetra Pak* | Alleged abuse of market dominance |
| July 2014 | Information technology | n/a | *Microsoft* | Alleged abuse of market dominance |

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*Source:* US-China Business Council, "Update: Competition Policy & Enforcement in China," May 2015, 27–33; Zhang Xingxiang, "China's Anti-Monopoly Law Enforcement: A Quest for Transparency, Consistency and Fairness," *Indiana University Research Center for Chinese Politics and Business* Working Paper #37, April 2015, Appendix II, 6–11; Zhong Lun Law Firm Antitrust Practice Group, *Competition Law Bulletin* Issue 8 (April 2015), 2.

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