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China Issues New Anti-Monopoly Rules and Procedures on Pricing Conduct

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INTRODUCTION

On December 29, 2010, China's National Development and Reform Commission ("NDRC"), one of the three agencies responsible for enforcing China's Anti-Monopoly Law ("AML"), issued new Anti-Price Monopoly regulations ("APM Rules") that clarify the type of price agreements and pricing behavior prohibited by the AML. The NDRC also issued Administrative Enforcement Procedural regulations ("AEP Rules") that illuminate the procedures and practices that will apply to investigations and proceedings related to anticompetitive pricing conduct. Both the APM Rules and AEP Rules become effective on February 1, 2011.

On January 7, 2011, another China antitrust agency, the State Administration for Industry and Commerce ("SAIC"), issued three regulations that clarify the circumstances under which non-price agreements and conduct may violate the AML. We will send a separate client alert that summarizes the key provisions of these new regulations in the near future.

SUMMARY OF THE APM AND AEP RULES

Price Agreements: The AML prohibits price-fixing agreements between competitors. The APM Rules provides additional details on the types of agreements among competitors that violate the AML, including agreements to:

- fix the price of goods or services;
- fix price ranges;
- fix commissions, discounts or other charges that affect price;
- use an agreed upon price as the basis for negotiation with a third party;
- agree on a standard formula to calculate price;
- agree not to change a price without the consent of another business operator; or
- fix prices through other means.

In determining whether pricing behavior is the result of concerted conduct, the NDRC will take into account the consistency of the relevant firms' pricing conduct, communications between the firms, and conditions in the relevant market (e.g., structure). Recent enforcement actions in China indicate that it is not necessary for the NDRC to establish that prices actually increased as a result of any concerted behavior or prove intent to increase prices.

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The new regulations also explicitly prohibit industry associations from:

- formulating and promulgating industry association rules, decisions or circulars that exclude or restrict price competition;
- organizing business operators to enter into price monopoly agreements prohibited by these provisions; and
- organizing other activities for business operators to enter into or perform price monopoly agreements.

Justifications for Price Agreements: Although the price agreements discussed above are prohibited by the AML (and considered *per se* unlawful in many jurisdictions), both the AML and the APM Rules permit the agreements if the parties can demonstrate that they will accomplish certain legitimate or procompetitive objectives, such as:

- improving technologies or the research and development of new products;
- improving product quality, lowering cost, increasing efficiency, unifying specifications and standards, or implementing a division of labor based on specialization;
- improving the efficiency and competitiveness of small- and medium-sized businesses;
- conserving energy, protecting the environment and providing disaster relief, or other public goods;
- mitigating the severe decrease of sales volume or obviously excessive production during economic recessions; and
- protecting legitimate interests in foreign trade or foreign economic cooperation.

It remains to be seen what circumstances would cause the NDRC to accept these justifications to permit a price fixing agreement that would otherwise be unlawful. Therefore, competing firms are wise to avoid entering into such arrangements and relying on one of these justifications unless they have consulted closely with counsel and have confidence that such a justification would be accepted by the Chinese authorities.

Pricing Behavior by Dominant Firms: The AML prohibits firms from abusing a “dominant market position.” It is important to remember that China presumes one or more firms have a dominant position when: (a) a single firm has a 50% market share, (b) two firms collectively have a 66-67% share, or (c) three firms have a combined 75% share. The APM Rules also provides further details on the types of price-related conduct by dominant firm that are considered unlawful in China, including:

- selling products at substantially higher prices than the same goods sold by other companies (or purchasing at substantially lower prices) or treating different counterparties differently under the same conditions without a justifiable reason;
- increasing the sales price (or decreasing the purchase price) “beyond a normal range” when costs are stable;
- increasing the sales price substantially higher than the increase in cost or decreasing the sales price substantially lower than the decrease in cost, as compared to other parties;
- selling at prices below costs without a “justifiable reason,” which could include:

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- selling fresh, seasonal, expiring or overstocked goods;
- selling at a reduced price because of debt payment, transfer of the business, or going out of business;
- promoting new products.
- refusing to transact business by setting “extraordinarily” high or low prices without a justifiable reason, which could include:
 - the counterparty has bad credit history, continuously deteriorating operations or other serious situations of substantial risk to the safe completion of the transaction; or
 - the counterparty is able to purchase (or sell) the same or substitute goods from other business operators for a reasonable price.
- requiring a party to trade exclusively with the dominant firm through the use of a price discount or other means without a justifiable reason, which may include:
 - safeguarding the quality and safety of the product;
 - maintaining the brand image or improving the service standard; or
 - reducing cost and increasing efficiency and enabling consumers to share in the benefits generated;
- imposing “unreasonable” charges.

Companies doing business in China should keep in mind that the NDRC also has responsibility for enforcing China’s Price Law, which can apply to other types of unilateral pricing conduct, such as: (i) the withholding of goods to manipulate prices, (ii) price increases resulting in “excessive” profits (which are considered twice “normal” profits), and (iii) false rumors of price increases.

Reporting and Leniency: Entities and individuals may report suspected unlawful conduct to the authorities, and the authorities are obligated to treat any reports confidentially. The investigating authority may, in its sole discretion, reduce or exempt a company that reports an unlawful agreement from possible fines.

- The first firm to report and provide material evidence is eligible for an exemption of any fine or penalty;
- The second firm to report and provide material evidence may receive a reduction in any penalty of no less than 50%; and
- Other firms that subsequently report violations and provide material evidence may also receive reduced penalties of no more than 50%.

The AEP Rules also indicate that an investigation may be suspended if the investigated firm agrees to eliminate the unlawful behavior within an agreed time limit and submit a written report regarding the performance of its assurances.

Investigatory Powers and Privilege Issues: The NDRC has the authority to delegate the investigation of suspected “monopolistic pricing” conduct to regional or local authorities; however, the AEP Rules contemplate that major and cross-jurisdictional cases will be handled directly by the NDRC. The relevant investigating authority may utilize the following measures in conducting its investigation:

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- enter and investigate the business premises of the suspected operator;
- require individuals and entities to provide explanations on relevant information;
- consult and copy relevant certificates, agreements, accounting books, business letters and emails, electronic data, documents, materials, etc.;
- seal or detain relevant evidence; and
- check the business operator's bank account.

Companies doing business in China should note that, unlike other jurisdictions such as the US or EU, China does not recognize an attorney-client or legal professional privilege for communications with either outside or in-house lawyers. Companies should therefore be mindful of sharing such privileged documents and communications with employees in China, as these could become discoverable by the Chinese authorities.

In addition, persons interviewed are obligated to explain relevant information requested by the authorities, and obstructive actions can result in civil fines and criminal penalties against individuals.

Effect of Foreign Conduct and Firms: The APM Rules states that these regulations apply to “overseas monopolistic pricing behavior” to the extent these activities have the effect of excluding or restricting competition in the domestic China market. It remains unclear how direct the pricing effects on China must be to trigger jurisdiction or enforcement authority, but firms doing business in China should understand that agreements that are formed outside of China may still be subject to the AML's prohibitions, if the activities could have some effect on the China market.

To date, there have already been a limited number of enforcement actions directed at price-fixing or cartel behavior in China. Despite fears in the international community that China may use the AML more aggressively against foreign firms, price-fixing enforcement actions to date have focused on the activities of local Chinese companies (e.g., rice noodle and other food suppliers).

Intellectual Property: The APM Rules apply to the “abuse of intellectual property rights to exclude or restrict competition by way of prices,” but do not apply to the otherwise lawful “exercise of intellectual property rights.” Given some of the prohibitions on pricing behavior by dominant firms, Chinese authorities could potentially seek to limit the ability of firms with significant IP assets from charging different or high royalties without justifiable reasons.

Abuses of Administrative Powers: The APM Rules prohibit state-owned firms from exploiting any controlling or exclusive economic positions they may have in a manner that harms consumers. The new rules also direct other administrative agencies not to abuse their powers to conduct price monopoly activities that are prohibited by the AML or APM Rules, including imposing discriminatory charges or standards for non-local goods.

Public Decisions, Penalties and Appeals: The investigated firm has a right to state its opinions to the authorities, and the Chinese authorities will make a determination on whether monopolistic pricing behavior has occurred based on the available evidence. If a violation is found, the investigating authority will issue a public decision.

The AML permits the authorities to impose fines of 1-10% of a firm's annual sales. Fines for recent violations of the AML and Price Law have ranged from \$3,000 to \$150,000. Even though the AML does not contain criminal penalties for violations (except obstruction), some reports have indicated the executives involved in the rice noodle cartel may have

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been arrested for pressuring or forcing others to participate in the cartel and violating general criminal laws.

Firms that disagree with any decision may file an application for administrative reconsideration or file an administrative lawsuit to appeal the decision.

CONCLUSION

Future enforcement actions will likely shed additional light on whether and how China's enforcement practices vary from practices in other jurisdictions, however, both new regulations and current enforcement actions indicate that there are areas in which China's approach will likely vary from other legal systems. Multinational firms doing business in China will need to adapt their compliance programs and business strategies to make sure that employees involved in China operations understand the potential differences and take appropriate steps to minimize the risk of an AML violation.

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