

China's NDRC Issues New Rules and Announces A New Price Cartel Investigation under the AML

On January 4, 2011, China's National Development and Reform Commission ("NDRC") published two new sets of rules under the Chinese Anti-Monopoly Law (the "AML") and announced the imposition of the maximum fine on a trade association that organized a price cartel in paper manufacturing. The announcement of the new rules and the enforcement action on the same day may indicate that NDRC is going to step up its enforcement efforts.

The NDRC's new rules are the Anti-Pricing Monopoly Rules (the "NDRC Pricing Rules") and the Procedural Rules on the Administrative Enforcement of Anti-Pricing Monopoly (the "NDRC Procedural Rules"), both of which will take effect on February 1, 2011. The NDRC Pricing Rules repeal the Provisional Regulation on the Suppression of Pricing Monopoly Conduct (the "Provisional Regulation"), which NDRC promulgated in 2003, and replace NDRC's August 12, 2009 draft Rules on Anti-Pricing Monopoly (the "2009 Draft Rules").¹ The NDRC Pricing Rules are a significant improvement on the Provisional Regulation, as the NDRC Pricing Rules provide much more detailed guidance regarding enforcement against price-related anti-competitive conduct. That said, the NDRC Pricing Rules give NDRC significant discretion and leave many questions unanswered.

This Memorandum summarizes NDRC's new rules and the agency's recent investigation into the price cartel organized by a paper manufacturing association.

I. BACKGROUND

Responsibility for the enforcement of the AML with regard to restrictive agreements, abuse of dominant positions and abuse of administrative power is divided between NDRC and the State Administration for Industry and Commerce ("SAIC").² NDRC is responsible

¹ For a more detailed discussion of the 2009 Draft Rules, please refer to our prior alert memorandum, available at: http://www.cgsh.com/chinas_anti-monopoly_law_one_year_on/.

² For completeness, the Ministry of Commerce ("MOFCOM") is responsible for merger control review and the investigation of anti-competitive conduct in international trade.

for enforcing the AML with regard to price-related conduct, while SAIC enforces the AML with regard to non-price-related conduct. SAIC has promulgated three substantive rules³ and two procedural rules⁴ regarding the application of the AML to non-price-related conduct.

II. THE NDRC PRICING RULES AND PROCEDURAL RULES

According to the NDRC Pricing Rules, the following three types of conduct are considered price-related anti-competitive conduct:

- Reaching restrictive agreements related to pricing;
- Abusing a dominant market position by using price-related measures to eliminate or restrict competition; and
- Abuse of power by administrative organizations using price-related measures to eliminate or restrict competition.

Article 4 of the NDRC Pricing Rules repeats the AML’s confusing statement that “the state shall protect the legitimate business activities of state-owned undertakings operating in industries implicating the national economic lifeline or state security,” or “having exclusive rights to operate in some specified industries according to relevant laws and regulations.” Such undertakings must operate within the law, should follow “the principle of self-discipline,” and “shall not impair consumers’ interests by exploiting a dominant position.” This language was not included in the 2009 Draft Rules. It is unclear if this article exempts certain companies from the AML or, perhaps, removes enforcement jurisdiction from NDRC.

³ SAIC’s final substantive rules were published on January 7, 2010 and will take effect on February 1, 2011. They include:

- Rules of the Administrative Authority for Industry and Commerce on the Prohibition of Restrictive Agreements (the “Restrictive Agreements Rules”);
- Rules of the Administrative Authority for Industry and Commerce on the Prohibition of Abuse of Dominant Market Positions (the “Dominance Rules”); and
- Rules of the Administrative Authority for Industry and Commerce on the Prohibition of Abuse of Administrative Power to Eliminate or Restrict Competition (the “Administrative Power Rules”).

⁴ Entered into force on July 1, 2009, the two final procedural rules adopted by SAIC are the Procedural Rules of the Administrative Authority of Industry and Commerce on Investigating and Handling Cases of Restrictive Agreements and Abuse of Market Dominance (the “Investigation Rules”) and the Procedural Rules of the Administrative Authority of Industry and Commerce on the Prohibition of Abuse of Administrative Power to Eliminate or Restrict Competition (the “Administrative Power Procedure Rules”).

In addition, Article 26 of the NDRC Pricing Rules restates the AML's provision on intellectual property, which provides that the rules do not apply to activity based on intellectual property laws and regulations, but do apply where an undertaking "abuses its intellectual property rights in order to eliminate or restrict competition." It is expected that further guidelines on intellectual property-related enforcement will be issued in the future.

A. RESTRICTIVE AGREEMENTS

The NDRC Pricing Rules prohibit competitors from fixing prices or discounts, using a standard formula to calculate prices, agreeing not to modify prices and similar conduct. Likewise, transaction counterparties may not fix resale prices or set minimum resale prices. Trade associations may not facilitate such conduct. As noted in Article 15 of the AML, these prohibitions do not apply to certain categories of agreements that have pro-competitive purposes and will not materially limit competition, such as those that improve product quality, reduce costs, and enhance efficiency or upgrade technology.

1. Concerted Actions

The NDRC Pricing Rules define price-related restrictive agreements as "any agreements, decisions, or other concerted actions that eliminate or restrict competition in price." To determine whether practices are in fact "concerted," NDRC will consider the degree of consistency in the relevant companies' behavior; whether there has been communication of intent among undertakings; the structure of the relevant market; and changes in the market. Notably, the final rules delete the definition of "consistency" provided in the 2009 Draft Rules, thus leaving NDRC with greater discretion. As a result of the lack of clarity, it is possible that parallel conduct not resulting from an agreement may be presumed unlawful. Consequently, the rules may chill competitors' ability to respond rationally and unilaterally to pricing competition.

Moreover, differences in the definition of "restrictive agreements" and "concerted actions" in the NDRC Pricing Rule and SAIC's Restrictive Agreement Rules may lead to confusion. Unlike SAIC's Restrictive Agreement Rules, the NDRC Pricing Rules fail to clarify that "agreements or decisions" include those in written and oral form. The SAIC's rules also define the term "concerted actions" as "where a consensus has in fact been reached amongst business operators, notwithstanding that no agreement or decision has been expressly established, whether in written or oral form." NDRC's rules omit such clarifications. While both agencies provide a similar list of factors to determine whether practices are in fact "concerted," SAIC's rules contain an additional factor – the existence (or not) of legitimate reasons for consistent behavior. These differences may complicate compliance efforts.

2. The Leniency Program

The NDRC Procedural Rules allow a company that engages in price-related restrictive agreements to seek an exemption or reduction in penalties in exchange for providing NDRC with important evidence that plays a key role in proving a violation. NDRC has discretion in reducing penalties or providing immunity to companies. In particular, the first leniency applicant to provide such evidence can get immunity from sanction, the second applicant can receive not less than a 50% reduction, and subsequent applicants can receive no more than a 50% reduction.

Compared with SAIC's leniency rules, set out in the Investigation Rules and Restrictive Agreement Rules, NDRC's rules provide more detailed guidance as to the level of fine reduction that an applicant may expect. However, they still leave many questions unanswered. For example, they do not specify the types of agreements to which leniency will apply. Typically, leniency policies apply to cartel behavior, as cartels are secretive in nature and therefore difficult to uncover using normal investigative methods, while other restrictive agreements may have pro-competitive effects that would complicate the analysis under a leniency program. Furthermore, the requirements to qualify for leniency lack clarity, and it will be difficult for a party to be sure that it has done everything necessary to obtain leniency. While SAIC's Restrictive Agreements Rules state that immunity and the reduction of penalties apply only to fines (not illegally gained proceeds), NDRC's rules are silent on this point. Importantly, it is unclear whether NDRC retains discretion to deny leniency to an applicant that meets all of the established criteria. Moreover, unlike SAIC's Investigation Rules, the NDRC Procedural Rules do not provide that leniency is not available for the organizer, or "ringleader," of a restrictive agreement. This leaves open the possibility that a cartel's ringleaders may be able to apply for leniency.

B. ABUSE OF DOMINANCE

With regard to abuse of dominance, the NDRC Pricing Rules offer guidance in respect of (1) NDRC's definition of a "dominant market position"; (2) how NDRC determines whether an undertaking holds a dominant market position; and (3) conduct that NDRC views as abusing a dominant market position.

1. Definition of a Dominant Market Position

Article 17 of the AML defines a "dominant market position" as a "market position in which an undertaking has the ability in the relevant market to control the price or quantity of products, or other transactional terms regarding products, or to impede or affect other undertakings' ability to enter the relevant market." The NDRC Pricing Rules further clarify

the phrases “other transactional terms” and “ability to impede or affect other undertakings’ ability to enter the relevant market.”⁵

2. Determination of a Dominant Market Position

Both the AML and the NDRC Pricing Rules provide a list of factors parties must consider when determining whether dominance exists. The factors in Articles 18 of both the AML and the NDRC Pricing Rules are largely identical.⁶ However, Article 18 of the NDRC Pricing Rules clarifies that the analysis must be based on the identification of a relevant market. In addition, unlike SAIC’s Dominance Rules and the 2009 Draft Rules, the NDRC Pricing Rules lack detailed explanations of each of the factors. This will likely leave NDRC with greater discretion in assessing market dominance.

3. Abuse of a Dominant Position

Consistent with the AML, the NDRC Pricing Rules prohibit, without valid justification, predatory pricing, refusals to deal, exclusive dealing, and price discrimination. The rules also prohibit “unfairly high” or “unfairly low” pricing and the imposition of unreasonable fees in addition to sales price. While the AML and the NDRC Pricing Rules do not require that the enforcement authorities prove that the alleged abuse harmed consumers, they do provide that a dominant company can defend its allegedly abusive conduct by providing a “reasonable justification.” The AML does not define what constitutes a “reasonable justification,” but the NDRC Pricing Rules provide further guidance on the reasonable justifications available for each type of abuse.

The following sections discuss some of the more interesting aspects of the NDRC Pricing Rules discussion of particular abuses of a dominant position.

a. Unfairly High or Low Pricing

While the AML does not address what constitutes an “unfairly high” or “unfairly low” price, Article 11 of the new rules enumerates the following elements:

⁵ “Other transactional terms” include “factors other than price and quantity of products that may materially affect market transactions, including product quality, payment conditions, delivery methods, after-sale services, trading options, and technology restrictions *etc.*” “The ability to impede or affect other undertakings’ ability to enter the relevant market” refers to “the ability to exclude from or delay entry into the relevant market by other undertakings in reasonable time or increase considerably the costs of entry into the relevant market by other undertakings such that they cannot effectively compete with the incumbent undertakings.”

⁶ The factors include the market share of the allegedly dominant undertaking, its ability to control the sales market, and barriers to entry.

- Whether prices are obviously higher than those of like products sold by other undertakings or obviously lower than those of like products purchased by other undertakings;
- Whether unusual price increases or decreases occur when costs are unchanged;
- Whether price increases are substantially larger than cost increases; and
- Whether decreases in purchase price are significantly larger than cost decreases of counterparties.

The NDRC Pricing Rules improve on the 2009 Draft Rules by removing as a factor whether the sales price is obviously higher than costs or the purchase price is obviously lower than the counterparty's costs. This change should help those companies that do not price their products solely based on costs. However, the rules continue to use the price charged by competitors as a benchmark, which is problematic as it may create the perverse incentive for companies not to compete on price. Moreover, the new rules provide no guidance on measuring cost either here or in the Article 12's discussion of below-cost pricing.

b. Below-Cost Pricing

Article 12 prohibits a dominant undertaking, without valid justification, from selling products at prices below cost. Notably, the definition of below-cost pricing, which was included in the 2009 Draft Rules, has been eliminated and the rules provide no guidance on how to measure cost.

Examples of "reasonable justifications" for below-cost pricing include:

- Disposing of seasonal or perishable products or overstocked products;
- Price reductions to pay off debts or to change or terminate the business; and
- New product promotions.

The NDRC Pricing Rules eliminate two justifications listed in the 2009 Draft Rules, namely responding to competitors' below-cost pricing strategies and benefiting from economies of scale.

c. Refusal to Deal by Setting Excessively High or Low Price

Article 13 prohibits a dominant undertaking, without valid justification, from refusing to deal with a transaction counterparty by setting excessively high or low prices.

The new rules omit the definition of “excessively high or low prices” that was provided in the 2009 Draft Rules. Again, NDRC has given itself added discretion in interpreting its rules.

*d. **Other Abusive Conduct***

The NDRC Pricing Rules introduce two new provisions that were absent from the 2009 Draft Rules. Article 15 prohibits the imposition of unreasonable fees in addition to the sales price. Article 16 prohibits a dominant company, without a valid justification, from imposing an exclusive dealing requirement through price discounts or other methods.

Interestingly, the NDRC Pricing Rules do not list any reasonable justification for the new prohibition against unreasonable fees or Article 16’s price discrimination prohibition.

C. ABUSE OF ADMINISTRATIVE POWER

Articles 20-22 of the NDRC Pricing Rules prohibit administrative authorities from engaging in the following conduct:

- Setting discriminatory charges for non-local commodities;
- Carrying out discriminatory pricing standards for non-local commodities;
- Stipulating discriminatory prices for non-local commodities; and
- Compelling undertakings to engage in any price-related anti-competitive conduct; and
- Stipulating regulations that have the effect of eliminating or restricting price competition.

These provisions are similar to those under the AML and shed no new light on the prohibitions.⁷

⁷ The AML prohibits the abuse of administrative power to eliminate or restrict competition. When such an abuse occurs, however, it is up to the superior authority of the authority accused of the violation to correct the situation. The anti-monopoly authorities may propose remedial actions but cannot impose them. As per the AML, the NDRC Procedure Rules provide that NDRC and authorized pricing authorities may only make recommendations to the appropriate superior administrative authorities for action.

III. RECENT CARTEL ENFORCEMENT

On January 4, 2011, the same date that NDRC publicized the NDRC Pricing Rules and the Procedural Rules, the agency announced the results of its investigation into a price cartel organized by a paper manufacturing trade association in Fuyang, a city in Zhejiang Province. The agency found that, in 2010, the trade association organized five meetings at which more than 20 members discussed and agreed on price increases and coordinated output. Based on those findings, NDRC held that the association violated the Price Law and the AML and imposed a fine of RMB 500,000, the maximum fine for trade associations under the AML and the Regulations on Administrative Sanctions for Price-Related Illegal Conduct (the “Regulations on Administrative Sanctions”).

This is NDRC’s second decision referencing the AML. NDRC and the provincial pricing authorities previously conducted an investigation into a price cartel among rice noodle producers in Guangxi province.⁸ In the rice noodle case, although both the AML and the Price Law were invoked, some interviews and press reports suggest that NDRC and its local agencies relied more heavily on the Price Law. Since the new rules have been issued, NDRC may feel more comfortable applying the AML. At the same time, it is likely that the agency will continue to apply the Price Law, a law with which it is much more familiar and which does not require it to share jurisdiction, alongside the AML.

As the paper manufacturing trade association received the maximum fine, clearly leniency was not applied. In contrast, even though NDRC had not proposed a leniency program at the time of its investigation of the rice noodle cartel, the 12 producers who cooperated with the investigation, provided important leads, and took corrective measures on their own initiative were all granted immunity from monetary penalties. Such immunity would not seem possible under the NDRC Procedural Rules, which clearly provide that only the first applicant to apply for leniency will receive complete immunity. On the other hand, as the new rules do not specify how to determine “the first applicant,” it is also possible that the agency may interpret the term broadly to include the first group of applicants that provide important evidence simultaneously or within a short period of time.

⁸ In addition, certain provincial pricing authorities conducted investigations into cartels operated in the following industries: tableware disinfection products, explosive products, badminton, insurance, internet bars, teas and milk products. Furthermore, the provincial pricing authorities in Jiangsu and Hubei conducted investigations into the abuse of dominance through tying by local salt manufacturers in their respective administrative regions. For a more detailed discussion of the rice noodle and tableware disinfection product cartel investigations, please refer to our prior alert memorandum, available at: http://www.cgsh.com/de/first_price_cartel_cases_under_the_chinese_aml/.

IV. CONCLUSION

The NDRC Pricing Rules and the Procedural Rules have provided important guidance on the application of the AML. However, they still leave many questions unanswered.

Inconsistencies in NDRC's and SAIC's rules could result in confusion and complicate NDRC's and SAIC's enforcement tasks as well as companies' compliance efforts. The problem of inconsistencies is particularly acute when a case involves both price and non-price-related conduct. Unfortunately, neither NDRC nor SAIC has provided any guidance on handling instances of concurrent jurisdiction.

Moreover, certain key concepts that were defined or clarified in the prior draft of the NDRC Pricing Rules have been removed, leaving NDRC with greater discretion in the implementation of the rules. In addition, while the NDRC Procedural Rules set out a framework for a leniency program, considerable work is still required to ensure procedural transparency and legal certainty. Furthermore, inconsistencies between SAIC's and NDRC's leniency rules may discourage parties from seeking leniency and thus undermine the benefits of a leniency program.

Despite these limitations, NDRC's new rules constitute a relatively complete body of implementing rules and should enable the agency to move forward with its AML enforcement activity. The agency's announcement of the investigation into the paper-manufacturing price cartel on the same day it released the new rules seems to indicate that it is stepping up its enforcement efforts. Indeed, the tough sanctions imposed on the trade association may signal the agency's readiness to take a more aggressive approach to cartel enforcement.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Antitrust and Competition in the "Practices" section of our website at <http://www.clearygottlieb.com>.

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