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Double Exposure to Legal Risk Under Anti-Monopoly Law and Anti-Unfair Competition Law

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Double Exposure to Legal Risk Under Anti-Monopoly Law and Anti-Unfair Competition Law

While the recent enactment of the Anti-Monopoly Law (AML) in the People's Republic of China has attracted a great deal of media attention, a less glamorous body of law should also be taken into consideration when a foreign business operating within China assesses the risks related to its business practices. For example, being deemed as having an exclusive sales arrangement could be a cause for concern under both the AML and the Anti-Unfair Competition Law (AUCL), as well as provincial anti-unfair competition legislation.

For the purposes of this article, an "exclusive sales arrangement" is defined as an arrangement where a seller/trader provides a certain economic benefit to its counterparty in exchange for a promise by the counterparty not to sell the products of the seller's competitors.

Where a business operator with a dominant market position (DMP Operator) is involved, the AML considers an exclusive sales arrangement to be an abusive action by the DMP Operator. Article 17.4 of the AML expressly provides that a DMP Operator is prohibited from unjustifiably limiting a transaction counterparty by restricting the counterparty to conduct transactions only with the DMP Operator or other business operators designated by the DMP Operator.

Furthermore, an exclusive sales arrangement may also trigger compliance concerns under the AUCL and other provincial anti-unfair competition regulations.

For instance, a business selling an imported product entered into an arrangement with other businesses by which the latter could only sell the products that were sold to them by the former. As consideration, the former paid promotional fees to the latter. The Administration of Industry and Commerce (AIC) in Changsha punished the former according to the AUCL and the Interim Regulations on Prohibiting Commercial Bribery issued by the PRC State Administration for Industry and Commerce (SAIC) in 1996. Moreover, the AIC located in Chengdu punished the latter in accordance with the Anti-Unfair Competition Act of Sichuan province. Both AICs issued their punishment decisions on the basis of two facts: there was a contract containing an exclusive sale arrangement, and the parties to the contract had performed the contract.

In addition to Sichuan, other provinces have passed similar anti-unfair competition legislation. For example, the Anti-Unfair Competition Act of Hubei province provides that a business operator may not restrict another party from doing business with the competitors of the business operator in question. Both Shenzhen City and Guangdong Province provide for similar rules. However, some provinces or municipalities (*e.g.*, Beijing, Shanghai) do not specifically address this issue.

Commercial Bribery Concerns

The aforementioned regulations do not expressly regard a payment made in relation to an exclusive sales arrangement as a commercial bribe. However, in practice, some AICs may regard the benefits that are transferred for exclusive promotional sales as commercial bribery.

It may be difficult for non-Chinese lawyers to understand why the exclusive sales arrangement could be investigated as commercial bribery under the AUCL or provincial anti-unfair competition rules. In European and US practices, commercial bribery is commonly viewed as a breach of fiduciary duty—by an exclusive sales arrangement, it seems that no breach of

fiduciary duty has ever happened. However, there is a peculiar form of commercial bribery under the AUCL that can be referred to as “anti-competitive commercial bribery”.

Anti-competitive commercial bribery happens where no fiduciary duty has been breached. What is breached or compromised is the free functioning of the market, which is what the AUCL was formulated to protect and what the enforcement authority safeguards. For example, some insurance companies pay procedural fees (or commission) to the concerned insurance agents at a higher rate for the insurances on life accident than the rate that is set by the State. In 1997, Henan Provincial AIC made an inquiry with the SAIC about whether or not this action constitutes commercial bribery. The SAIC replied that this action infringed upon the competition order of the insurance market and formed the action of commercial bribery. Therefore, the AIC should investigate and punish this action in accordance with the AUCL and the Interim Regulations on Prohibiting Commercial Bribery.

In addition, the AUCL provides for a blanket prohibition on an overarching spectrum of commercial bribery activities, by which a business operator (*e.g.*, a company or enterprise) may not use valuables or other methods to induce its counterparty to buy or sell goods.

Anti-Unfair Competition Regulations Apply a Different Standard than the AML

Unlike the AML, where a reasonability standard will be applied by the relevant government authority when assessing an exclusive sales arrangement, under the AUCL and related provincial-level regulations, such an arrangement is often construed to be a *per se* violation. As such, the enforcement authorities (*i.e.*, AICs) would impose punishments according to the concerned offending actions. That being said, some defenses that might be available under the AML would not be applicable to the cases investigated under the AUCL.

Hopefully, the implementation rules of the AML will specify what the defenses are—the AML, again, is not clear in this regard. The AML prohibits a DMP Operator from unjustifiably limiting a transaction counterparty by restricting the counterparty to conduct the transaction only with the DMP Operator or with other business operators designated by the DMP Operator. The word “unjustifiably” indicates that the enforcement authority must take account of any defenses that would justify the exclusive sales before issuing a punishment decision.

Uneven Law Enforcement

On a final note, it must also be mentioned that law enforcement is uneven throughout China. An exclusive sales arrangement in one province may be less likely to be prohibited than in another. As you may see from two case studies below, the courts in Longyan City and Xiamen City overruled administrative decisions of the AICs on the ground that an exclusive sales arrangement was a legitimate contractual relationship other than an arrangement for commercial bribery.

Conclusions and Suggestions

The exposure to risk under the AUCL (and related provincial regulations) could be currently more significant than those risks under the AML. Businesses should analyse their compliance with the AUCL and various provincial anti-unfair competition regulations. Because of uneven law enforcement, businesses which might not be DMP Operators should only consider exclusive sales arrangements in areas where it is clear that the relevant government authorities are friendly to such arrangements.

Case Study: *Min Xi Hotel v Longyan AIC*

The AIC in Longyan City, Fujian Province, found that a hotel took commercial bribes because it had reached an agreement to sell the products of a certain supplier exclusively. However, when the case was subjected to judicial review, the court overruled the decision of the Longyan AIC.

On 6 June 2002, the Min Xi Hotel and the Ji Ma Company entered into an agreement for the exclusive promotion of the sale of Huaxia Great Wall Wines (专场促销协议). The Ji Ma Company is a sales agent of Huaxia Great Wall Wines. The exclusive promotion agreement provided that the Min Xi Hotel would make its best efforts to promote the sale of Huaxia Wines; salesmen for wines of other trademarks and trade names were prohibited from doing any promotional work within the Min Xi Hotel; the Min Xi Hotel should put Huaxia Wines in prominent places in bars, wine cupboards and VIP rooms; and the Min Xi Hotel should provide space within the hotel for Ji Ma to conduct promotional activities related to Huaxia Wines. In consideration, Ji Ma Company was to pay Min Xi Hotel an exclusivity fee of RMB 86,160 on an annual basis for its exclusive rights as well as an entrance fee of RMB 18,000. After signing the exclusive promotion agreement, the Ji Ma Company paid RMB 78,120 to the Min Xi Hotel (prorated for nine months), which was used by the Min Xi Hotel to cover its advertisement expenses and directly write off a certain amount of its business expenses.

On 12 November 2003, the Longyan AIC determined, in accordance with the AUCL and the Interim Regulations Prohibiting Commercial Bribery, that the exclusivity and entrance fees that the Min Xi Hotel received from the Ji Ma Company constituted commercial bribes. As a result, the Longyan AIC confiscated the RMB 78,120 that the Ji Ma Company had paid the Min Xi Hotel and imposed a RMB 30,000 fine upon the Min Xi Hotel. The Min Xi Hotel then requested judicial review of the Longyan AIC's determination with the Xinluo District People's Court of Longyan City, Fujian Province.

The Longyan AIC submitted that the exclusivity and entrance fees were actually used as a means to preclude the competitors of the Ji Ma Company from operating within the Min Xi Hotel; the Min Xi Hotel did not categorize the fees as income, but rather, it used the fees to directly write off certain advertising expenses that the hotel incurred; and the Min Xi Hotel did not spend the fees to promote the Huaxia Wines that the Ji Ma Company sold. Therefore, it had determined that the exclusive promotion arrangement was in fact a commercial bribery scheme.

As support for its arguments, the Longyan AIC cited an SAIC circular regarding whether publicity fees, advertisement fees and commercial sponsorships could constitute commercial bribery. In the circular, the SAIC emphasized that publicity fees, advertisement fees and commercial sponsorships should be expenditures actually incurred for publicity, advertisement and other sponsorship activities. In the absence of any publicity, advertisement and/or other sponsorship activities, any fees offered would constitute commercial bribery because such fees are economic benefits beyond normal merchandise price or service expenses. The circular specifically notes that even if the said fees are publicly given and taken by way of contracts or supplementary agreements, the receipt of such fees should be considered the acceptance of bribes.

Simply put, the courts of the first and second instance were not convinced by the submissions of the Longyan AIC. Both courts held that fair competition did not mean that the Min Xi Hotel must permit salesmen of competitors of the Ji Ma Company to engage in promotional activities on the premises of the Min Xi Hotel or display all wines in the same way, and no law prohibited the Min Xi Hotel from opening its premises for the purpose of promoting wines. As such, the Min Xi Hotel merely created conditions for certain wine dealers to promote the selling of their wines while enabling itself to profit. By charging fees, the Min Xi Hotel had not violated the cardinal free market principle of allowing for fair competition. Therefore, the Min Xi Hotel and the Ji Ma Company had entered into a legitimate contractual relationship, and had not engaged in any commercial bribery scheme.

Case Study: *Ji Ma Company v Xiamen AIC*

In 2004, the Ji Ma Company was investigated and punished for engaging in commercial bribery by the AIC of Xiamen because of its exclusive promotional sales in Xiamen. The Ji Ma Company requested judicial review of the Xiamen AIC's determination. The courts (in the first and second instances) ruled in favor of the Ji Ma Company because the fees that it had paid for the exclusive promotional sales, as ruled by the Xiamen Intermediate Court (*i.e.*, the second and final instance court), were not commercial bribes as long as they were truthfully accounted for in their accounting books.