



IN THIS ISSUE

China Passes Anti-Monopoly Law

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A Chinese Strategy for Defending Against Defects

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China Passes Anti-Monopoly Law

On 30 August 2007, the National People's Congress, China's top legislature, passed the Anti-Monopoly Law (AML), which goes into effect on 1 August 2008. The AML marks an important moment in China's legal history. After more than 10 years of drafting and preparing this "economic constitution", China has moved from being a planned economy to a market economy.

The AML covers the areas of monopoly agreements, abuse of dominant market position, market concentration by business carriers and abuse of administrative powers to restrict competition. It also stipulates the process for investigating suspicious monopoly behavior and the legal liability for monopoly behavior. A summary of the AML's major points follows.

Horizontal and Vertical Monopoly Agreements

The AML defines two types of monopoly agreements: a monopoly agreement between the competing business carriers (horizontal monopoly agreement), and a monopoly agreement between the undertaking and certain transaction party (vertical monopoly agreement). Both horizontal monopoly agreements and vertical monopoly agreements shall be deemed illegal and invalid upon investigation and recognition by the Anti-Monopoly Enforcement Agency.

Generally, once an agreement meets the definition of a horizontal monopoly agreement, it is invalid, due to its obviously illegal nature of eliminating or restricting the market competition. However, recognition of a vertical monopoly agreement shall be reviewed and made on a case-by-case basis.

The Chinese government is considering establishing an agreement pre-consultation system. Under the proposed system, companies and other business carriers could voluntarily submit the proposed agreements to the government for pre-judgment.

Market Concentration by Business Carriers

Market concentration by business carriers is another major topic the AML covers. The following actions are defined as concentration by business carriers:

- Mergers conducted by business carriers
- Controlling other business carriers by acquiring their shares or assets, or by other means
- Acquiring control over other business carriers by contract or other means, or by obtaining the ability to exercise decisive influence over other business carriers by contract or other means

The "control" or "ability to exercise decisive influence" includes the arrangement of management positions or employment relationships, intellectual property licenses or ownership, and other commercial contracts.

In accordance with Article 21 of the AML, business carriers are obliged to notify the Anti-Monopoly Enforcement Agency regarding concentration reaching the threshold of notification stipulated by the State Council. However, the AML does not provide details on the notification procedure, except the four documents and an open-ended clause stipulated in Article 23. The four documents are a notification form, an evaluation report on the impact that the business concentration may impose on the relevant market, the business concentration agreement and the

audited financial statement of all the concentration-involved business carriers in the previous year. The Anti-Monopoly Enforcement Agency under the State Council has the right to require other documents.

Special Regulations for Industry Associations

Compared to previous drafts of the AML, the passed AML adopts strict liability for industry associations that organize and encourage monopolistic conduct by their members. An industry association that engages in monopolistic conduct is liable for a fine of up to RMB500,000 and deregistration as a legal association. The background of this regulation is that many industry associations have led or organized several collective price-increasing activities for various types of commodities, which had a serious impact on the market.

Examinations for Foreign Investments

The AML is the first time that a law clearly requires foreign investments to pass both an anti-monopoly examination and a national security examination. Such a requirement increases the burden of approval for any foreign investment in China that might be deemed concentration in a certain industry.

Anti-Monopoly Authorities

The AML establishes government authorities authorized to govern monopolistic conduct. These authorities include the Anti-Monopoly Committee and the Anti-Monopoly Enforcement Agency. The Committee is a coordination and research organization that drafts the national policy and framework of anti-monopoly matters and resolving conflict among various agencies. The Anti-Monopoly Enforcement Agency is the main government authority in charge of daily anti-monopoly affairs.

Legal Liabilities

Unlike the antitrust law of the United States, the AML does not adopt criminal punishment for the liabilities of monopolistic conduct. Only administrative sanctions and economic punishment will be imposed on violators of the AML. Violators will face punishment fines of up to 10 per cent of their annual sales, in addition to the confiscation of all their illegal gains.

In general, the AML establishes the framework and principles of the anti-monopoly practice system of China. However, the provisions of the AML are still very general and not very practical. Given that there are nine months until the AML goes into effect, we can expect more specific AML implementation rules or regulations to be promulgated by Chinese authorities during this period.

A Chinese Strategy for Defending Against Defects

Disputes involving products imported from China have recently gained much attention in the media. Many of these reports stem from news regarding U.S. companies that outsource production to China and/or purchase Chinese goods for re-sale in the United States, and have been held liable for damages caused by defective Chinese products in U.S. courts.

There are also legal liabilities within China for having produced and/or sold defective products. Under China's Product Quality Law, it is clear that an enterprise engaged in the production or sale of defective products is, *inter alia*, subject to fines of up to three times the value of the products illegally produced or sold, the revocation of its business license and criminal prosecution. As a result, it is critical that a U.S. company with interests in China devise a strategy to protect itself from potential liability stemming from product defects. The following article examines what these risks are and proposes methods to minimize any potential liability.

Overview of Chinese Product Liability Law

Although perhaps contrary to the picture portrayed in the U.S. media, China has laws on its books pertaining to defective products. In fact, since the Product Quality Law and the Consumer Protection Law came into effect in the early 1990s, there has been a steady increase in the number of cases based on product liability claims heard in Chinese courts.

Moreover, both the State Technological Supervision Bureau (STSB) and the State Administration of Industry and Commerce (SAIC) have jurisdiction over matters concerning defective products. As a result, even though a foreign-invested enterprise—*e.g.*, a joint venture or a wholly foreign-owned enterprise (WFOE)—might somehow avoid liability in the courts (due to the lack of a claim filed by a Chinese plaintiff), it may still be subject to administrative sanctions. Closely tracking the Product Quality Law, these sanctions may include orders to cease sales; orders requiring the repair, replacement and return of products sold; warnings; confiscation of products; confiscation of illegal income gained; destruction or ordering of technical rectification of products; the assessment of fines; ordering the closure of businesses; and the revocation of the business license.

In sum, the potential for liability under Chinese law is very real. Even if damage awards may be relatively modest (particularly when compared to those awarded in the United States for punitive damages), the revocation of a business license or the possibility of criminal prosecution should put company executives on notice that serious problems can arise within China.

Managing Potential Liability

As aforementioned, notwithstanding the avoidance of litigation within the Chinese court system, a foreign-owned enterprise structured as either a joint venture or a WFOE which engages in either the production or sale of defective products may still be subject to serious administrative sanctions. However, it is possible to minimize these risks. If it is not necessary for a company to manufacture the product, a possible solution would be for a company with interests in China to set up an alternative structure—a representative office.

For either a company with established Chinese operations or a prospective entrant into the Chinese market, a representative office can be set up to coordinate purchases of products from an independent agent. Although a representative office is not a Chinese legal entity and is not allowed to engage in direct business activities, it can still conduct certain limited activities, such as forming business liaisons, product introduction, market surveys and research, and technological support. In this manner, a foreign business interest can carefully select manufacturers and help shield itself from potential liability.

Conclusion

The perception that China is lax in dealing with defective products is a misconception. China's product quality regime has made it much easier for consumers to sue companies for injury or damage resulting from the sale of a defective product, and administrative punishment can be just as severe. However, companies can take steps to reduce any potential liability within China by choosing to funnel their purchasing of products through a representative office.

Please note that any solution discussed here is, at best, a partial one and should be viewed as only one element in a global strategy designed to minimize risk. Any liability issues which could arise in the United States still would require careful planning.