

Double Exposure to Legal Risk Under China's Competition Laws: Comments Upon the Exclusive Sales Arrangements in China

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The 2008 enactment of the Anti-Monopoly Law (AML) in the People's Republic of China has attracted a great deal of media attention, but the Anti-Unfair Competition Law (AUCL), which was promulgated in 1993 and is less publicized than the AML, poses equally substantial compliance risks for foreign businesses. The AUCL seeks to regulate an array of practices that would impede the competitive orders of the market, with provisions governing the passing off and misappropriation of trade secrets, predatory pricing and tie-ins, abuse of administrative powers, bribery and unlawful discounts, misleading advertising and the organization of lotteries. One of the greater risks involves allegations of exclusive sales arrangements, which could violate both the AML and AUCL, as well as provincial anti-unfair competition legislation.

Defining Exclusive Sales Arrangements

An "exclusive sales arrangement" in this article, is defined as an arrangement where a seller/trader provides a certain economic benefit to its counterparty in exchange for the counterparty's promise not to sell a competitor's products.¹ If the seller/trader is a business operator with a dominant market position (DMP operator) an exclusive sales arrangement may be considered an abusive action under Article 17.4 of the AML because it restricts the counterparty to conduct transactions only with the DMP operator or other businesses designated by the DMP operator. Similar compliance concerns may be triggered under the AUCL and provincial anti-unfair competition regulations.

These regulations do not expressly regard a payment made in relation to an exclusive sales arrangement as a commercial bribe. In practice, however, some regional Administrations for Industry and Commerce (AICs) may take such a viewpoint, which is often difficult for non-Chinese lawyers to understand. In Europe and the United States, commercial bribery is commonly viewed as a breach of fiduciary duty.² As a practical matter in this view, no breach of fiduciary duty has occurred under an exclusive sales arrangement. However, there is a peculiar form of commercial bribery under the AUCL that can be referred to as "anti-competitive commercial bribery."

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Contrasting AML and AUCL Interpretations

In anti-competitive commercial bribery, the offense involves the free functioning market competition that the AUCL was formulated to protect.³ In addition, the AUCL provides for a blanket prohibition on a wide range of commercial bribery activities, by which a company or enterprise (not just a DMP operator) may use valuables or other methods to induce its counterparty to buy or sell goods. Commercial bribery is thus conducted with competition disordered and impaired, which might be better illustrated by the following inquiry and answer between a local AIC and the State Administration for Industry and Commerce (SAIC).⁴

Some insurance companies pay procedural fees (or commissions) to their insurance agents at a higher rate than that set by the State. Henan Provincial AIC asked the SAIC if such commissions constituted commercial bribery. The SAIC found that the commissions infringed upon competition in the insurance market and constituted commercial bribery. It instructed the AIC to investigate and punish this action in accordance with the AUCL and the Interim Regulations on Prohibiting Commercial Bribery.

This is in distinct contrast to the enforcement regime of the AML. The AML prohibits a DMP operator from unjustifiably restricting a counterparty to conduct a transaction only with the DMP operator or with other designated business operators. The word "unjustifiably" indicates that the enforcement authority must use a reasonability standard to take into account any defenses that would justify the exclusive sales before issuing a punishment decision.

Under the AUCL and related provincial-level regulations, there is no such reasonability standard and an exclusive sales arrangement is often construed to be a *per se* violation. Also, defenses that might be available under the AML would not be applicable to the cases investigated under the AUCL. The enforcement authorities (such as the AICs) would thus impose punishments according to their own views of the offending actions.

Case 1: A General Contractor of Tsingtao Beer Company (Tsingtao) Found to Have Committed Commercial Bribery in Exchange for Exclusive Selling Arrangements

In June 2006, and February and September of 2007, a general contractor of Tsingtao in Wenling entered into two distribution agreements with two alcohol distributors and signed several cooperation agreements with two hotels and one nightclub. According to these agreements, the contractor paid monetary incentives, described as "buyout fee" and "exclusive fee" totaling RMB 1.205 million to buy out the purchasing rights and distribution rights of the aforesaid companies who, under these agreements, could not sell or display beer of other brands and would solely promote Tsingtao beer. 50,000 boxes of beer were sold through this arrangement. The Wenling AIC held that the contractor had committed commercial bribery since it paid various "promotion fees" to first-tier distributors for the purpose of obtaining trade opportunities which distorted normal market order and eliminated other competitors, causing unfair competition. As such, the contractor and the other five companies together were fined up to RMB 1.727 million.⁵

Case 2: Tsingtao Found to Have Committed Commercial Bribery in Exchange for Exclusive Selling Arrangements.

In October of 2008, the Zhengzhou AIC launched a series of investigations against the Zhengzhou Branch of Tsingtao Beer (Tsingtao Zhengzhou) who was suspected of conducting commercial bribery. During the onsite investigation, a draft "display cooperation agreement" was discovered which stated that Tsingtao Zhengzhou, as Party A to such agreement, would pay a fee called "display incentive" to the undersigned restaurant who, as Party B, must display Tsingtao beer in its most visible spot inside, solely sell Tsingtao beer, and purchase from designated distributors with a minimum purchase of 20 boxes. After further investigation, it was also found that Tsingtao Zhengzhou entered into a similar cooperation agreement with a hotel in Zhengzhou by which the latter must sell no less than 1,080 boxes of Tsingtao draught beer and no less than 2,400 boxes of high quality beer between May 2007 and May 2008. The distributor, as a third party to the agreement, would pay RMB 13,200 to the hotel accordingly. In July of 2006, AIC Luoyang found Tsingtao paid from RMB 2,000 to RMB 70,000 to 30 hotels and restaurants respectively, and determined that such conduct constituted commercial bribery.⁶

Case 3: Pepsi Guangzhou Found to Have Committed Commercial Bribery When Seeking a Better Display Shelf

Pepsi Guangzhou entered into either "entry agreements" (进场协议) or "promotional display agreements" (促销陈列协议) with certain retail stores, by which the stores displayed a Pepsi product according to the requirements of Pepsi Guangzhou. As a result of the display, Pepsi Guangzhou paid "entrance fees" and "display fees" to these stores in the amount of RMB 247,900. The arrangement generated RMB 3 million in revenue, and made a profit of RMB 650,000. The Foshan branch of the SAIC (Foshan AIC) determined that Pepsi Guangzhou had committed commercial bribery by paying such fees to aid the selling of its products. As a result, Pepsi Guangzhou was fined RMB 50,000, and its profits were confiscated.⁷

The decision by Foshan AIC created a firestorm of criticism within both the legal and business community.⁸ As such, it is arguable about the extent to which Foshan AIC's decision will influence other AICs.

Uneven Law Enforcement

This distinction is significant because law enforcement is uneven throughout China. An exclusive sales arrangement in one province may be less likely to be prohibited in another. 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 business operator's competitors.⁹ Both Shenzhen City and Guangdong Province have similar rules.¹⁰ However, some provinces or municipalities (such as Beijing and Shanghai) do not specifically address this issue. Plus, courts can overrule administrative decisions of the AICs if they find that an exclusive sales arrangement was a legitimate contractual relationship other than an arrangement for commercial bribery.

Case 4: An Exclusive Sales Arrangement Is Not Bribery From the Perspective of a Court

The AIC in Longyan City, Fujian Province, found that a hotel took commercial bribes because it had reached an exclusive promotion agreement with a wine company sales agent to sell specific wines exclusively. The agreement provided that the hotel would make its best efforts to promote the sale of the wines; salesmen for wines of other trademarks and trade names were prohibited from doing any promotional work within the hotel. In consideration, the wine sales agent paid the hotel an annual exclusivity fee and an entrance fee, which the hotel used to cover certain advertising and business expenses. The Longyan AIC determined, in accordance with the AUCL, that the exclusivity and entrance fees constituted commercial bribes. It cited an SAIC circular which stated that, 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 hotel requested judicial review of the Longyan AIC's determination by the Xinluo District People's Court of Longyan City, Fujian Province. In the hearing that followed, the courts of the first and second instance rejected the Longyan AIC's determination. They held that fair competition did not mean that the hotel must permit salesmen of the wine company's competitors to engage in promotional activities on the hotel premises or display all wines in the same way, and no law prohibited the hotel from opening its premises for the purpose of promoting wines. As such, the hotel merely created conditions for certain wine dealers to promote the selling of their wines while enabling itself to profit. By charging fees, the hotel had not violated fair competition standards. Therefore, the hotel and wine company had entered into a legitimate contractual relationship, and had not engaged in any commercial bribery scheme.¹¹

A Financial Driving Force to Implement the AUCL

Governmental authorities are financially motivated to fight bribery. Each AIC is assigned an annual target for how large an anti-bribery fine should be imposed and collected. For example, by 2006, Wuxi AIC, Chong'an Branch, had five subsidiaries and one economic examination team (i.e., six investigation units). Each investigation team was assigned an annual task: each subsidiary was required to collect as much as RMB 1 million in fines while the economic team was to collect as much as RMB 2.5 million in fines, with a total annual goal of RMB 7.5 million. In 2004, Chong'an Branch finished the task and amassed fines totally RMB 7.5 million. In 2005, Chong'an Branch's actual collection exceeded the task assigned, with an amount of RMB 8.4 million. The year 2006 saw even higher collection amounts: In the first six months of 2006 Chong'an Branch collected fines of RMB 5.8 million. The financial motivation might give a falsely positive impression of the efforts of the AIC, but indicate the long-lasting driving force of the Chinese government in fighting bribery.

Conclusions and Suggestions

It is clear that the exposure to risk under the AUCL (and related provincial regulations) can be more significant than under the AML. Businesses should analyze their compliance with the AUCL and various provincial anti-unfair competition

regulations in this light and not depend on AML compliance alone. 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.

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¹ Article 17.4 of the AML provides that "a business operator with a dominant market position shall not abuse its dominant market position to conduct following acts: ... (4) requiring a trading party to trade exclusively with itself or trade exclusively with a designated business operator(s) without any justifiable cause."

² For example, the Penal Code of the State of Texas of the US provides that "a person who is a fiduciary commits an offense of commercial bribery if, without the consent of his beneficiary, he intentionally or knowingly solicits, accepts, or agrees to accept any benefit from another person on agreement or understanding that the benefit will influence the conduct of the fiduciary in relation to the affairs of his beneficiary. A person commits an offense if he offers, confers, or agrees to confer any benefit the acceptance of which is an offense commercial bribery." § 32.43(b) of the Texas Penal Code. Also available at: <http://tlo2.tlc.state.tx.us/statutes/docs/PE/content/html/pe.007.00.000032.00.htm> (last viewed March 18, 2008).

³ The AUCL, Article 1.

⁴ See the Reply of the SAIC on the Issue of Determining and Disposing of Payment and Collection of Insurance Procedural Fees Higher Than the Standards Set by the State (Gong Shang Gong Zi [1997] No. 256).

⁵ For details, please see <http://money.163.com/08/0704/10/4G0I6NFC00252FE1.html> (in Chinese only).

⁶ Please see <http://www.niangzao.net/news/923/92358.html> (in Chinese only).

⁷ For additional details, please review <http://news.hexun.com/2009-09-25/121206960.html> (in Chinese only).

⁸ Please see criticisms related to this case, available at <http://economy.enorth.com.cn/system/2009/09/25/004214998.shtml> (in Chinese only).

⁹ Anti-Unfair Competition Act of Hubei Province, Article 17.2.

¹⁰ Rules of Shenzhen Economic Special Zone in Implementing the Anti-Unfair Competition Law of the People's Republic of China provide that a business operator shall not unjustly prevent another party from establishing a normal trading relationship with the competitors of the business operator in question; or illegally force another party to relinquish a normal trading relationship with the competitors of the business operator in question (Article 10.1). The Methods of Guangdong Province in Implementing the Anti-Unfair Competition Law of the People's Republic of China provide that a business operator shall not prevent other parties from establishing normal trading relationships (Article 13.4).

¹¹ The Case on the Administrative Punishment Decision of Minxi Hotel v. Longyan City Administration on Industry and Commerce by Longyan Intermediate People's Court of Fujian Province (2004) Yan Xing Zhong Zi No. 28.