



MMLC Group 

北京铭辉达知识产权代理有限公司

Lawyers and Consultants

BEIJING
709, Tower W3
The Towers
No.1 East Chang An Avenue
Dongcheng District 100738
Beijing, China
北京东城区东长安街1号东方广场东方经贸城
西三办公楼709室, 邮编100738
writer's p: +86 10 8515 1091
f: +86 10 8515 1089
w: mmlcgroup.com

“China’s Auto Sector Draft Antitrust Guidelines”

By Xia Yu and Joyce Chng
MMLC Group
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On March 23, 2016, China’s National Development and Reform Commission (NDRC) published the Automobile Sector Draft Antitrust Guidelines (the ‘Draft Antitrust Guidelines’) for public comment due April 12, 2016. As a result of frequent rounds of antitrust investigations in China’s auto sectors over the past few years, the Draft Antitrust Guidelines addresses the industry practices that have been distorting competition in the market. The Draft Antitrust Guidelines includes the opinions of major market players, industry associations, consumer associations, academic experts and legal practitioners. It contains six chapters, which addresses issues of fundamental principles, such as relevant market definition, and various other topics, including anticompetitive agreements, abuse of dominant market positions, merger control, and abuse of administrative power in the automotive industry.

The Draft Antitrust Guidelines provide guidance for evaluating diverse common industry practices in the sector, mostly relating to the vertical relationship between automakers, auto parts manufacturers, distributors, and after-sales services providers. The Draft Antitrust Guidelines also provide a series of exemption scenarios and outlines anti-competitive practices. Finally, for the first time, it introduces safe harbour thresholds for evaluating certain types of vertical restraints. Therefore, in response to the need for an in-depth analysis and examination into the causes and occasion of monopoly practices in the auto sector, the NDRC has created the Draft Antitrust Guidelines in order to provide guidance and clarity on prohibited monopoly practices, and parameters for exemptions, where possible.

The importance of competition law

Competition is central to the operation of markets. It brings important benefits to the consumer by encouraging enterprise, innovation, efficiency and a widening of choice; enabling consumers to

BEIJING

With support offices in Brisbane and Sunshine Beach
Matthew Murphy Ellen Wang Hong Mei Yu Du
Xia Yu Sarah Xuan Fei Dang

Partners and Associates in the MMLC Group are admitted to practice law in China, Australia and Europe (UK)

buy the goods and services they want at the best possible price; and contributing to a country's economy. China's recognition of the importance of fostering competition first emerged with the creation of the Provisional Rules on Expediting Economic Alliance, promulgated in 1980 by the State Council, which aimed to break down the territorial blockades and departmental barriers. This was followed by the State Council Provisions Rules on the Launching and Protecting the Socialist Competition in 1980, which aimed to step by step reform the existing economic management system and actively promote and protect the smooth competition, as well as the State Council Rules on Further Expediting and Protecting Socialist Competition in 1986. These three regulations are understood as composing the embryo of competition law in China, and were intended to break down the historical planning economic monopoly in the pre-1980's era and to promote the initial and basic market economic and competition.

From 1987 onwards, a drafting team was formed to formally proceed to draft the Anti-Monopoly Law of the People's Republic of China, which came into effect in 2008 in the context of a growing competitive market economy. Since then, China has established itself as one of the most active antitrust regimes in the world, impacting international business activities with its vigorous merger control regime, antitrust investigations resulting in multi-million dollar fines and antitrust litigation on complex information technology, and intellectual property rights related issues. The Anti-Monopoly Law is enforced by three agencies, including the Ministry of Commerce (MOFCOM), the State Administration for Industry and Commerce (SAIC), and the National Development and Reform Commission. The MOFCOM is an executive agency of the State Council of China, and through the Anti-Monopoly Bureau, is responsible for reviewing merger and acquisitions transactions and other types of proposed business concentrations.

China's emphasis on the automobile sector

Over the past decades, China's automobile industry has risen to become the largest in the world based on unit sales. Off the back of this growth, foreign automakers have, in an otherwise stagnant industry, enjoyed substantial success in China. The industry's rise has been carefully managed and nurtured by the Chinese government with the ultimate objective of developing a domestically driven automotive industry. Their basic policy strategy has been to open market access to foreign automakers in exchange for technology transfer through a 50:50 Sino-foreign equity joint venture structure. However, the market since then has become proliferated with a maze of complex partnership structures between domestic and international players, with some employing monopolistic practices in order to take advantage of the success. Consequently, China's antitrust authorities increased their attention on the automobile industry. In 2012, the China Automobile Dealers Association carried out a review of industry commercial policies, spare parts supplies, and after-sales services upon the instruction of NDRC. This revealed a number of monopoly practices in employment all over China, leading to multiple investigations, such as the *12 Japanese Auto Parts and Bearing Manufactures Case*, where record fines were imposed on 12 Japanese auto parts and bearing companies, including Hitachi, Denso, Furukawa Electric, Yazaki, Sumitomo, Asian Industry, Mitsuba and Mitsubishi, who engaged in price related monopolistic behaviour, totalling RMB 1.24 billion. Therefore, this indicates the government's recognition of the need to balance the increasing and successful automobile industry against poor market structure, unregulated development and an opaque consumer market. Thus, the Draft Antitrust Guidelines was created.

Also, while there are no regulations over other specific industries, the *Regulation on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights* was released in August 2015 in order to regulate over other industries, particularly the technology, Internet, and pharmaceutical sectors. This is due firstly, to the regular and common employment of monopoly practices in these areas, and secondly, the fact that the targeted

industries are often consumer-facing, indicating NDRC's responsiveness to consumer complaints or perceived public concern.

Antitrust investigations in the auto sector

The NDRC has been entrusted by the Anti-Monopoly Commission under the State Council with the drafting and finalization of the Draft Antitrust Guidelines, as they are well placed to lead the drafting due to its accumulation of significant enforcement experience from a series of antitrust investigations and surveys into the sales of vehicles and the auto parts industry over the past few years. Especially, the NDRC agency has uncovered both vertical and horizontal agreements in many cases, which indicate the industry itself contains features playing a large role in raising antitrust scrutiny. This may be due to the long industrial chain involved in the sector, with each link in the chain being highly susceptible to antitrust behaviour. In 2015, alone, a total of RMB 2 billion of monopoly-related fines were issued in the auto sector.

One of these investigations included German automobile manufacturer Mercedes-Benz, who was fined RMB 350 million in April 2015, along with a combined RMB 7.87 million on its dealers. The fine was a result of Mercedes-Benz conclusion and implementation of resale price maintenance agreements to fix the minimum process of E and S Class cars, as well as certain auto parts. According to the full penalty decision published by the Jiangsu Price Bureau, Mercedes-Benz had fixed the minimum price of E Class and S Class cars in the Nanjing, Wuxi, Changzhou and Suzhou markets through telephone, oral communication and meeting with dealers. They had also concluded an agreement with dealers in Jiangsu Province to fix the minimum resale price for auto parts, whereby it provided different levels of discount for insured cars, cars with expired warranty periods and cars within the warranty period. Mercedes-Benz had implemented the minimum price agreement by tightening its performance review of dealers, tracking the sales process and increasing the intensity of this assessment, issuing warnings and reducing support for dealers if there was refusal to cooperate with the price-fixing policies, and interviewing the employees of dealers and requesting terminations if they engaged in serious violations of the resale price maintenance agreement.

Another investigation involved Dongfeng Nissan, who was fined in 2015 RMB 123.3 million, with its dealers fined RMB 19.12 million. The Guangdong Provincial Development and Reform Commission commenced investigations, yielding illegal monopoly practices surfacing after a year of investigating Dongfeng Nissan and its Guangzhou regional distributors. It was revealed Dongfeng Nissan had violated the Anti-Monopoly Law by improperly enforcing minimum prices, which although is common other countries, is considered a violation of free market competition in China. Specifically, Dongfeng Nissan employed price management regulations to control the sale prices offered by Guangdong-based dealers online, on the phone or at the sales outlet, as well as the final transaction price.

Price-related restrictions

Corporation agreement between competitors: the Draft Antitrust Guidelines acknowledge that certain types of cooperation agreements between competitors can be pro-competitive, and that such agreements include joint research and development agreements, such as cooperation agreements between competitors to research and develop new energy cars, as well as other agreements such as specialisation agreements, standardization agreements, joint production agreements, and joint procurement agreements. Such agreements are likely to be eligible for an individual exemption under Article 15 of China's Anti-Monopoly Law, which allow agreements with the following objectives:

- a. agreements made to improve technology, to research and develop new products;

- b. agreements made for the purpose of improving product quality, reducing cost, improving efficiency, unifying standards, norms or specialization;
- c. agreements made by small and medium-sized enterprises to improve operational efficiency and to enhance their competitiveness;
- d. agreements made to cope with economic depression, to mitigate a serious decrease in sales volumes or excessive overstock;
- e. agreements made to achieve public interests, such as saving energy, protecting environment, relieving the victims of a disaster and so on;
- f. agreements made to maintain legitimate interest in the cooperation with foreign economic entities and foreign trade; and
- g. other cases stipulated by laws and the State Council.

Under Article 14 of the Anti-Monopoly Law, agreements are prohibited if they include fixing the price for resale; restricting the lowest price for resale; or other monopolistic agreements identified by the anti-monopoly authorities. In support of this, the Draft Antitrust Guidelines provide four scenarios whereby a resale price minimum arrangement can be individually exempted from prohibition, therefore providing entities with the possibility to apply for an exemption in an individual case for resale price fixing and minimum resale price fixing, provided that such practices do not appreciably affect competition and will also benefit customers. Therefore, the four types of minimum resale price fixing that may fall within the scope of application for exemption include:

- a. resale price fixing and minimum resale price fixing during a promotion period of new energy motor vehicles;
- b. resale price restrictions in a distribution arrangement under which the distributor merely acts as an intermediary to coordinate the sales process whereas the sales price is mutually agreed by the motor vehicle supplier and the designated third party/end user;
- c. resale price restrictions in government procurement; and
- d. resale price restrictions on e-commerce platforms through which the motor vehicle supplier concludes the sales with the end users and merely engages the distributor as an intermediary to provide assistance in the sales process, such as delivery of motor vehicle, collection of payment and issuance of invoice.

Therefore, the NDRC is taking into account concerns expressed by representatives of carmakers, who have stated it has been difficult enough to generate revenue with the current market conditions without being offered extra subsidies, and have responded accordingly by expanding the causes for exemption for agreements that may otherwise be illegal under the Anti-Monopoly Law.

Restrictions on territory and customer

While the Anti-Monopoly Law provides for under Article 14 the prohibited agreements, there was a lack of clarity as to the extent the restrictions on territory and customers are legally permissible. Under the Draft Antitrust Guidelines, restriction on territory means the supplier agrees to supply to one or several distributors in a particular territory and, at the same time, such distributor(s) undertake not to conduct their sales activities in other territories. Restriction on customer means the supplier requires the distributor(s) to resell the products only to, or not to a particular group of customers. Generally, restrictions on territory and customers are considered to be creating anti-competitive effect. For the first time however, the Draft Antitrust Guidelines give guidance on the types of restrictions as substantially anti-competitive and in general shall not be allowed:

- a. restriction of passive sales by dealers;
- b. restriction of cross-supply between dealers;
- c. restriction of auto spare parts sales to end-customers by dealers and auto repairers; and

- d. restriction of sales of auto spare parts and other equipment by the suppliers to dealers, auto repairers and end customers, except in case of OEM contracts.

Therefore, exemption is possible only on a case-by-case basis. Furthermore, the Draft Antitrust Guidelines introduces a market share threshold of 25-30%, which functions as a safe harbour. The following types of restrictions are considered under the Antitrust Guidelines as eligible for an exemption under Article 15 of the Anti-Monopoly Law if there is satisfaction of the above thresholds and such practices have proven to yield efficiencies and are justified:

- a. territorial restrictions that do not restrict passive sales or cross-supply;
- b. restriction of active sales into non-allocated regions;
- c. restriction of direct sales to end-customers by wholesalers; and
- d. restriction of auto parts sales by dealers to customers who use such auto parts to manufacture the same products as the auto suppliers

Abuse of dominant market position

The Draft Antitrust Guidelines seek to regulate over abuse of dominant market positions in the aftermarket. Except for the spare parts produced under OEM agreements, a manufacturer of motor vehicles with a dominant market position shall not restrict a manufacturer of original spare parts for initial assembly of motor vehicles, without due reasons, from placing its trademark, logo, component code on those parts. Furthermore, the Draft Antitrust Guidelines prohibit automakers with dominant market position from many practices, including

- a. restricting auto parts suppliers from placing their own trademarks or logos on spare parts;
- b. restricting dealers or repairers' access to spare parts of equivalent quality or their ability to purchase original spare parts from alternative channels;
- c. restricting dealers or repairers' ability to sell spare parts; and
- d. restricting the attainability of technical maintenance information.

Other restrictions

The Draft Antitrust Guidelines lists unreasonable vertical restraints in the auto repair and servicing market such as maintenance by authorised repairers, use of original spare parts, and maintenance of parallel imported cars. Also, the Draft Antitrust Guidelines consider that the tying of products, such as the motor vehicle supplier requiring the distributor or repairer to purchase tied products, may result in an exclusive purchase obligation for tied products, and is therefore restricted. Forcing the distributors or repairers to accept unreasonable sales target and stock requirements may also result in an exclusive purchase obligation for the relevant products, and forcing the distributors and repairers to engage designated suppliers or purchase through designated supply channels and purchase designated third party brand products for their business premises decoration is considered to give rise to anti-competitive effect in the relevant market and indirectly increase the cost in distribution and aftermarket chains.

Conclusion

The Draft Antitrust Guidelines will have wide and profound implications for the auto sector. It sheds light on previous uncertainties on the recognition of anti-competitive behaviour, and will cause relevant parties in the supply, distribution and aftermarket chains of the motor vehicle sector to review and adjust their current market practices to adapt to the Draft Antitrust Guidelines. Ultimately, the Draft Antitrust Guidelines seek to correct and improve its regulation over possible monopoly practices in the auto sector while ensuring its regulations are not overly suffocating or detrimental for an automobile manufacturer business to grow in an otherwise difficult market and take into account its current industry policy on encouraging e-commerce platform sales and

promoting new energy vehicles. Therefore, its ultimate aim is to improve China's competition in the auto sector area, and overall to have a positive effect on China's economy.