We want to welcome everyone to the re-launched China Law Reporter. As many of you may remember, the China Committee of the ABA Section of International Law had published the China Law Reporter for many years, which was well received by its members. Through the hard work of our co-editors, James Zhang of Loeb & Loeb LLP, Andrew Minear of Fried, Frank, Harris, Shriver & Jacobson LLP and Meph Jia Gui of Global Law Office, we are proud to recommence publication of the China Law Reporter. This edition includes articles on China related legal topics, including antitrust, cybersecurity and employment. We hope you enjoy it and find it worthwhile.

Once again, our thanks to the co-editors for their efforts in putting this together.

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I. INTRODUCTION

In recent years, the issue of “fair competition review” has become a key priority for the Chinese Central Government in its consideration of competition policy and a hot topic in the circle of Chinese agencies, jurists and economists specialized in competition policy. China has attracted widespread attention since the promulgation of the Opinion on Establishing a Fair Competition Review System during the Development of Market-oriented Systems (“Opinion”) by China’s State Council on June 1, 2016 and the successive implementation of the Opinion by China’s local governments thereafter.

The fair competition review, according to the Opinion, is a mechanism enforced by the policy-making organs to review whether the regulations and policy measures involving market entry, industrial development, foreign investment attraction, tendering and bidding, government procurement and business code of conduct, fall into one of four prohibited categories. The competition agencies and the Legislative Affairs Office of China’s State Council shall assist these departments with the implementation of the review.

It is impossible for China to establish a fair competition review system without imperfection at the outset. Therefore, a review of its historical background seems necessary in order to achieve a better understanding of its evolution, imperfections and solutions to such imperfection.

II. HISTORICAL BACKGROUND
Before 1993, China had been a centrally planned economy without necessary and due stress on the role of the market economy regime. That situation has been shifted to a huge extent since 1993 when China was determined to establish a socialist market economy regime. Since then, the Chinese central government has tried to reshape the relationship between government and markets by means of deregulation, decentralization, adoption of the rule of law and reform of state-owned enterprises.

However, this process has moved back and forth because of China’s heavy reliance on industrial policy by governmental agencies, the intertwined sector interests and widespread local protectionism in China, which has resulted in “a larger government and a smaller market.” This reliance, interconnectivity and protectionism can be seen from, and have been proven by, the fact that China’s State Council announced its four trillion RMB market-rescue plan in 2008, hoping to address the international financial crisis and drive its double-digit annual GDP growth. However, it has been known to the public for its unsatisfactory results and side effects up to the present.6

In that same year, China adopted its Anti-Monopoly Law (“AML”), which has also attracted wide attention. Many people have attached great hopes to its possible role in pushing forward the above process, but it had turned out that it was less admirable in early years.7

Many agencies and researchers specialized in competition policy have agreed that one of the main reasons for such less admirable result in China is her lack of competition policy, which is relatively weak in comparison with the more influential industrial policies.8 Since the latter is centered on short-term economic performance and administrative approach, it is inevitable to bring about some drawbacks, which have indeed hampered China’s current economic reform in the long run.9

These agencies and researchers have also acknowledged the limits of the AML in terms of restraining the expanded industrial policy. As a result, they advocate that the Chinese central government should take more measures in this regard and their proposals have been accepted in the end. In November 2013, China made an ambitious decision to establish a better market economy regime, with a focus on the safeguarding of a fair competition environment, which has been regarded as an official will of less government intervention and early official thoughts about the would-be fair competition review system in China.

Meanwhile, since its accession to the WTO, China has shouldered a number of international obligations which call for modifications of its relevant domestic economic and trade

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8 Competition Policy first appears in Article 9 of the AML, which reads, “the State Council established the Anti-Monopoly Commission, which...fulfills the responsibilities, including researching and drafting competition policy...”
9 Mr. Jinglian Wu, a prominent economist, pointed out that, “Our industrial policy... chooses to support some industries and enterprises and limit others. This policy is obviously anticompetitive and exists in almost all economic sectors in China.” See: http://www.icc-ndrc.org.cn/Detail.aspx?newsId=5926&TId=99.
policies and laws which were incompatibility with WTO law.\textsuperscript{10} The requirement of compatibility has enhanced competition among various WTO members due to global economic integration. It has also pushed the convergence of domestic laws and rules, which requires, and is featured by, a “rule of law” government, more property protection, less market intervention and much fairer market competition. China has no reason to be an exception in this regard.

Therefore, it is necessary for China to establish the fair competition review system in order to meet the domestic demand for sustainable economic growth, faced with international pressure and to fulfill its international obligations, and make timely responses to the calling of agencies, jurists and economists engaged in competition policy. This is a major step forward and reflects the rising role of competition policy in China’s public policies. Nevertheless, the implementation of this review has to overcome several challenges.

III. IMPERFECTIONS IN THE IMPLEMENTATION OF CHINA’S FAIR COMPETITION REVIEW

\textit{A. Cognitive Imperfection}

Concept is the basis for, and has external and internal influence on, deeds. Therefore, the first imperfection in China’s competition policy should stand at the conceptual level. By concept, it refers to the cognizable limitations of competition policy by many policy-makers in China.

Although the scope of competition policy varies in different jurisdictions, it at least includes competition advocacy and competition law enforcement. The fair competition review system is the main component of China’s competition advocacy. To that extent, it is safe to say that China’s competition policy is basically complete.

However, the formulation of competition policy doesn’t mean that it will naturally be one of China’s basic economic policies. Many policymakers in China’s central and local governments have an incorrect understanding of competition policy, which can be proven from two aspects. On one hand, policymakers have heavily relied on industrial policy to boost the economy instead of building a fair competition environment. For example, when the central government supported the photovoltaic industry,\textsuperscript{11} some provinces assisted local firms in this industry through local industrial policies, which constituted discriminative measures against non-local firms in many ways.\textsuperscript{12}

\textsuperscript{10} The former director of the Department of Treaties and Law, Ministry of Commerce (“MOFCOM”) mentioned that, “the rules of WTO have played a basic role in the development of China’s foreign trade. The accession to WTO has not only brought us legal improvements…” See Xiaojie Lv ed., \textit{Ten Year’s Accession to WTO and the Rule of Law in China}, People’s Publishing House, 2011.

\textsuperscript{11} China’s State Council once stressed that, “[the governments shall] treat distinct photovoltaic enterprises differently, primarily support major enterprises which have advanced technology and market competitiveness and expel interior enterprises.” See: \url{http://www.gov.cn/zwgk/2013-07/15/content_2447814.htm}.

\textsuperscript{12} For example, the Department of Energy in Jiangxi Province only provided provincial subsidy to the programs that used the photovoltaic products from its province. See: \url{http://nyj.jxdpc.gov.cn/filePub/201604/W020160426577772697700.pdf}. However, such discrimination against non-local firms is prohibited by China’s National Energy Administration. See: \url{http://zfxxgk.nea.gov.cn/auto87/201601/20160114_2096.htm}. This shows that even if the Chinese central government makes an adjustment of its policy, local governments could still carry out anticompetitive policies based on their interests.
On the other hand, the Chinese government or authorities sometimes violate the AML without realization of its illegitimacy. In 2016, China’s State Administration for Industry and Commerce (“SAIC”) authorized its Anhui branch to investigate a cartel, which was organized by the Hefei Central Sub-branch of the People’s Bank of China. This Sub-branch invited three firms, which sold payment ciphers, and 20 financial institutions in Anhui province, to attend the bidder’s conference. It was at the meeting that, according to the arrangement and notification by the Sub-branch, the participants reached an agreement on the payment ciphers’ price and type, market allocation plan and distribution measures. After the meeting, the Sub-branch assigned these three firms to deal with certain financial institutions respectively on the condition that they should not make contact or transactions with the clients of any other side. Undoubtedly, this is one typical case of cartels arranged by government departments.13

B. Contradiction Related to Regional Gap, Official Performance and Review Implementation

The second imperfection arises from the contradiction between and among the uneven regional economic development and local officials’ pursuit of political achievements and their weights and influences on the implementation of the fair competition review system. Since China launched its reform and opening-up in 1978,14 its unbalanced regional development policies have contributed to the huge economic success of coastal areas.15 However, it has also resulted in side-effects such as huge development gaps between these regions and the rest of the country. Although the Chinese central government has begun to employ a coordinated development strategy for the eastern, central and western regions since 1991, the gaps have remained to the present. Therefore, different regions may have different attitudes toward the implementation of the fair competition review system because of their distinct motivations, resources and approaches.

First, the developed regions usually have a relatively mature market development, due to which governments therein have more inclination to embrace market mechanism and restrict their powers. Under such circumstances, the main motivation to implement such a system is to safeguard fair competition, which is in line with the Opinion.16 However, the underdeveloped regions usually have a relatively low marketization, due to which governments therein have more inclination to intervene in markets. Under such circumstances, those governments have no, or less, motivation to conduct fair competition because such a system is incompatible with their habitual approaches.

14 China’s Reform and Opening-up has been a long-term national policy since Xiaoping Deng initiated it in 1978, aiming at, among other things, shifting China’s centrally-planned economy to the market-driven one, promoting international trade and attracting foreign capitals and technologies to boost domestic development. This policy has, to a great extent, led to China’s economic success and political changes since 1978. See: http://news.xinhuanet.com/ theory/2008-12/05/content 10458896.htm.
15 See, Houkai Wei, The Economic Transformation within the Past 30 Years since the Reform and Opening-up, 5 Economic Perspectives 9 (2008).
16 The Opinion pointed out that, “Establishing a fair competition review system, and preventing excessive and inappropriate government intervention in the market are conducive to ensuring resources are allocated in a way that maximizes benefits and optimizes efficiency according to market rules, market prices and market competition.”
Second, the developed regions usually have a number of relatively high-level policymakers and enforcement personnel involved in competition law, whose expertise can be given full play to the implementation of such a system. In contrast, there may be few human resources for the underdeveloped regions, and it is more difficult for them to take advantage of their expertise because of the lack of motivation of their regional governments to implement such a system.

Last but not least, developed regions attach more importance to the rule of law and property rights protection, and as a result, they are more likely to include the review system in their regional legal systems and make it long-term and systematically binding on their government powers. In contrast, the underdeveloped regions may put aside such a system because of their undue reliance on administrative policies and orders in their governance, and there may be a higher possibility of putting aside such a system in the event of a combination of the foresaid reasons.

In addition, there may be a conflict between the local officials’ pursuit of short-term political achievements and their implementation of such a system. The former means that they may use government power to intervene in the regional economy in a more active way so that the respective regional or personnel benefits may be maximized in a short period. However, such practices may not only hamper the healthy development of a market economy, but also run contrary to competition policy in terms of safeguarding fair competition and realizing a long-term healthy economic development, and the system may come to naught in the end.

C. Conflict Between Reform and Review

The Chinese central authorities initiated the supply-side structural reform in 2016 in order to alleviate the contradictions on the supply side and stimulate China’s economic growth. This reform is featured by its cutting industrial capacity, destocking, de-leveraging, lowering corporate costs and improving weak links. Cutting industrial capacity mainly refers to the elimination of overcapacity in the field of iron and steel and the coal industry which have been featured by their low profits and high pollution. Although it has been repeatedly stressed that the market’s key role should be played, there have still been inclinations in respective regional governments to achieve de-capacity targets through administrative orders from their policy orientation of “adhering to more Merger and Acquisition and re-organization than bankruptcy and liquidation” and their stresses on the policy of “good re-location of employees and bottom social security.”

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17 See, Steven Cheung put forward the concept of “county economy” in his work, The Economic System of China, that the inter-province competition is the main reason for China’s economic miracle in the 1980s. That inter-province competition is an example in this regard. However, many defects can be attributed to such competition. For example, local officials may attach importance to short-term economic effects which may hamper market competition. See, Steven Cheung, The Economic System of China, CITIC Publishing Group, 2012.

18 De-capacity aims at the dissolution of surplus capacity, destocking focuses on the reduction of inventory of commodity house, de-leveraging refers to the decrease of leverage existed in financial system and used by enterprises, lowering corporate costs point at the reduction of systematic cost in transaction and unreasonable tax and fees borne by enterprises, and improving weak links requires improvement in poverty alleviation, new industry cultivation, service industry promotion, infrastructure development, ecologic governance, etc. See: http://news.xinhuanet.com/fortune/2016-05/27/c129021077.htm.

There are two questions involved in the foresaid de-capacity. The first is the conflict between market economy disciplines and administrative intervention. In a market economy, those enterprises with low profits and high pollution are eliminated because of market competition and strict environmental protection laws. Governmental intervention is in violation of competition policy because governmental behavior should “restrict competition to the minimization” according to such policy and the fair competition review system.\(^{20}\) Furthermore, there is no sustainability for de-capacity dominated by administrative organs from the perspective of effects. The second is that priority should be given to relocation or reemployment for the benefits of employees. De-capacity dominated by government will inevitably result in questions of relocation and reemployment. Plans for such relocations have been formulated by many regional governments, which have increased the cost or burden of public finance in essence.\(^ {21}\) However, the re-location may not be a question for government if such de-capacity is realized or completed by bankruptcy or reorganization under the spontaneous market influence. What the government should take into account is how to further the reemployment and reduce employment measures taken by enterprises which are against competition.\(^ {22}\) Although reemployment falls into the category of other public policies, it can still promote the competition in the human resources market, whereas measures adopted by enterprises against competition obviously fall into the category of competition policy. The simultaneous implementation of these two polices will be conducive to the enlargement of the human resources market and the increase of internal market competition. Therefore, the fair competition system should be applied to the consideration of the supply-side structural reform dominated by the government with an intention of de-capacity.\(^ {23}\)

**D. Lack of Independent Third Party for Fair Competition Review**

The Opinion stipulates that:

Policy-making Organs shall, during the policy-making process, conduct rigorous self-review pursuant to review standards. Policies that are considered as will not exclude or restrain competition upon review may be implemented, while those that will exclude or restrain competition shall not be promulgated or shall be promulgated only after being adjusted to meet relevant requirements. Policies that have not been subject to fair competition review may not be introduced.

Furthermore, the Opinion clearly provides that “they are encouraged to entrust third parties to carry out assessment.” However, there are still many problems for such self-review.


\(^{21}\) In the *Administrative Measures for Special Rewards and Subsidies for Structural Adjustments of Industrial Enterprises* issued by the Ministry of Finance, the central public finance has arranged 100 billion RMB to support the overcapacity reduction by local governments and central SOEs. It will allocate 24 billion RMB to the resettlement of employees. See: [http://js.mof.gov.cn/zhengwuxinxi/zhengcefagui/201605/P020160519546386062558.pdf](http://js.mof.gov.cn/zhengwuxinxi/zhengcefagui/201605/P020160519546386062558.pdf).


\(^{23}\) Jiangping Wang, SAIC Deputy General Director, believes that the precondition for the supply-side structural reform is a healthy market regime and it depends on the basic role of competition policy.” See, Jiangping Wang, *On the Basic Role of Competition Policy in the Supply-side Structural Reform*, 11 Administration Reform 12, 2016.
First, there are huge differences between different regions and authorities in terms of self-review dynamics. Second, the organs in charge of policy formulation or competition policy should directly annul those policies and measures, namely, the four kinds and 18 types of policies and measures provided for in the Opinion which is obviously formulated to exclude or restrict competition effects. However, there should be a complex economic consideration of those policies and measures without such obvious effects. Assessment conducted by a third party is a plausible way because the authorities in charge of policy formulation lack experience in complex economic analysis in general. At present, China lacks a professional and independent third party economics assessment institution, and as a result, there may be a higher possibility from the current situation that such authorities are more likely to approve such policies and measures with dim effect against competition. That is to say, there may be a higher false negative in governmental policies and measures against competition.

E. Lack of Due Process for Fair Competition Review

The fifth problem relates to the lack of due process. The Opinion provides that “Policy-making Organs shall listen to the opinions of interested parties, or solicit public comments. After relevant policy measures are promulgated, they shall be disclosed to the public pursuant to the Regulations of the People’s Republic of China on Government Information Disclosure.” Despite this, the Opinion itself can’t be sufficient to that end. It is extremely difficult to have effective monitoring from the outside if there is no open and due procedure for the review process. For example, after the Beijing Municipal Commission of Transportation published the Rules for the Administration of Network-based Reservation Taxi Business and Service in 2016, one lawyer wrote to the Commission to inquire whether the Rules had gone through the procedure of fair competition review. The Commission explained that principles for the review were whether the Rules were formulated according to law because administration by law was a top requirement and it had no contents of excluding or restraining competition. However, there are still controversies about whether the sole access to the drivers with local household registration and to the cars with local automobile registration is against the Opinion. The public had no other way to know and monitor the review standard and process because no review procedure was released by the Commission.

F. No Opportunity for China’s People’s Congresses to Review Budget Considerations

The final institutional challenge is the deficiency of fair competition review in the budgetary considerations by the Chinese central and local people’s congresses. The funds for China’s numerous industrial policies mainly come from the annual budgets approved by the people’s congresses. The new Chinese Budget Law, which was enacted in 2014, adopted multiple standards for budget considerations, such as the legality and reasonableness of budget arrangements and debts, and appropriateness of budget arrangements for the major expenditures

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24 Id 5.
25 U.S. Judge Frank Easterbrook analyzed the false positive and false negative in antitrust enforcement. If we borrow this to think about public anticompetitive policies and measures, we shall maximally eliminate them, which embrace false positive wrongs. See, Frank H. Easterbrook, Limits of Antitrust, 63 Texas Law Review 1, 1984.
27 See: http://www.legaldaily.com.cn/index/content/2017-01/13/content_6955611.htm?node=20908.
and investment projects. However, it has no provision on whether budget arrangement may exclude or restrain market competition, not to mention the supervision of budget implementation from the perspective of fair competition review.

It is almost impossible for Chinese People’s Congresses at all levels to cancel or modify the industrial policy arrangements because of short periods for their consideration of draft budgets, numerous projects involved and financial complexity. The lack of fair competition review in budget considerations and supervision will definitely increase the ex-post costs and difficulties to correct the anticompetitive policies. What’s more, regardless of being required by the Opinion, it may be difficult for, and there may be no jurisprudential basis for, authorities in charge of industry policy formulation to conduct self-review of “existing policies” and “incremental policies.” On one hand, those authorities may resist the self-review by exploitation of “existing policies” review under the pretext that the current policies have been approved according to legal procedure; on other hand, those authorities may take a negative attitude toward the implementation of the Opinion against their reviews of “incremental policies” on the grounds that such reviews have not been provided for in the Budget Law and its relevant rules, and that they have no statutory obligation to abide as a result.

V. SOLUTION TO PERFECTING FAIR COMPETITION REVIEW SYSTEM IN CHINA

Although there have been so many imperfections in terms of the Chinese fair competition review system, there are still plausible solutions to such imperfections from different perspectives.

First, China should advance the status of its competition policy. Establishing the fair competition review and enforcing the AML are the initial steps to reinforce Chinese nascent competition policy. Predictably, China has to walk back and forward before its competition policy finally substitutes the industrial policy and becomes one of its fundamental economic policies.

To achieve this target, the Chinese competition policy community should try to persuade key policymakers, state-owned enterprises, private firms and the public to realize the advantages of competition policy and disadvantages of industrial policy, and share the view with them that competition policy needs to play a central role in the Chinese market economy. Of course, it will take a long time and patience to reach a consensus, which calls for the joint efforts of the Chinese courts, agencies, jurists and economists specialized in competition policy.

Second, China may introduce fair competition review into the system for assessment of local officials’ political achievements. Regional leaders and officials may harm the competition policies beyond their levels for local protectionism or other reasons because the local

29 See Article 48 of the Budget Law of the People’s Republic of China. There is no provision requiring consideration from the perspective of competition policy.
developments have bigger and direct influence on their career promotion in comparison with competition policies above their levels. Therefore, China may make an improvement in its system for assessment and promotion of local officials by introduction of a competition policy record in order to have a better and leveled development with less unnecessary competitive construction and more necessary fair competition.

Third, China may reform the current supply-side structural reform by using competition policy. The policy preference of the supply-side reform to administrative order has been costly and probably unsustainable. This approach is nothing new, but an old-fashioned and customary repetitive construction. Market-driven reform, as claimed by itself, shall come into play. However, the shift from the government-led track to the market-driven route would be much tougher and more sophisticated than anyone could imagine. As a practical matter, it would be an operational attempt to put this reform under competition policy and focus on the fair competition review of its stimulus measures, such as the financial rewards to local governments and resettlement arrangements.\footnote{Jiangping Wang, the Deputy Director General of SAIC stated that, “the Supply-side Structural Reform shall depend on a healthy market system and the fundamental role of competition policy.” Jiangping Wang, \textit{Strengthening the Fundamental Role of Competition Policy in the Supply-side Structural Reform}, 11 Administration Reform 12 (2016).}

Fourth, China should make systematic legislation of fair competition review. At present, the Opinion has been a general public policy and many provisions need to be formulated. Therefore, China’s State Council should, within a reasonable period, draft and enact the \textit{Rules for the Implementation of the Fair Competition Review} according to law. The Rules should include the authorities, criteria, due process and liabilities in terms of such review. In particular, with regard to the review of “existing policies” and “incremental policies,” the Rules should establish competition agencies and governmental legal authorities as review authorities and the policymaking authorities as supporting ones. Additionally, the review procedure has to be open to the public and adopt hearing procedures.\footnote{See: \url{http://www.bjrd.gov.cn/zdgz/zyfb/bg/201702/t20170206_170507.html}.

Fifth, China should push for coordination between its fair competition review and budget laws. It is necessary to review the industrial policy arrangements when drafting, approving and implementing budgets. This requirement should be a part of the Budget Law and local Regulations on supervision over budgets. The Beijing Municipality took a lead in this regard. In January 2017, Beijing’s Department of Finance, after hearing the advice from the members of the Finance and Economy Committee of Beijing Municipal People’s Congress, amended its \textit{Report on the Budget Implementation in 2016 and Budget Draft in 2017} to Beijing Municipal People’s Congress. A clause was added in the Report which provides that “when making finance policies in support of industrial development and government procurement, the government and its departments shall implement fair competition review to regulate their con-ducts.”\footnote{But this initiative has to be pushed harder and further by merging this statement into the \textit{Regulations on Supervision over Budgets of Beijing Municipality}, which is under modification.}

Sixth, China should promulgate its \textit{Rules for the Implementation of Fair Competition Policy Review}. Currently, there are only 18 types of obviously anticompetitive policies under the Opinion. However, more in-depth economic analysis is vital for the assessment of the uncertain
restricted policies. In fact, it is an optimal choice to enact the Rules. By learning from the competition assessment toolkit of the OECD,\(^\text{33}\) the Rules, along with economic analysis, can be utilized by the review bodies to evaluate different industries. On the basis of these review results, the authorities could gradually clear the “existing policies.” As a law of great significance with a would-be basic economic policy for China, the drafting of such Rules should be opened to the public and there should be full consideration of the opinions from practical, academic and the social experts. The task should be assigned to the Competition Commission or the three central competition agencies. Although China’s State Council has established an Inter-Ministerial Joint Meeting for the Fair Competition Review, it is difficult to operate and coordinate because it consists of 28 ministries and commissions.\(^\text{34}\) Under this framework, the three competition agencies and the Legislative Affairs Office, which are members of the Meeting, are expected to play leading roles.

Lastly, China should strengthen the public and private AML enforcement to public anticompetitive policies. Some provinces and municipalities have promulgated their follow-up versions of the Opinion.\(^\text{35}\) But they share a common flaw – similarity of content with the Opinion, and lack of thoughtful and enforceable plans. Frankly speaking, this review still stays in a vacuum. The local implementations of the review may be worse if motivations, resources and approaches of self-review are taken into consideration.

The 18 prohibited policies provided for in the Opinion could be a part of the AML, which is also hostile to the abuse of administrative power to eliminate or restrict competition. Now that policymaking authorities seem to be reluctant to enforce the Opinion, the competition agencies could do more according to the authorization of the AML.\(^\text{36}\)

The implementation of this review also depends on the courts. The rulings against the anticompetitive policies, which would be used by corporations affected by them, could be another powerful external restraint to the policymakers and in turn force their self-review.\(^\text{37}\)

VI. CONCLUSION

The enactment of China’s fair competition review system is a major step toward the strengthening of its competition policy. However, implementation of the system has to overcome many difficult institutional, legal and systematical obstacles in the long run, such as the cognizable limitations of competition policy by many policymakers, the uneven local economic development and officials’ pursuit of political achievements, the current administrative supply-
side structural reform, the absence of independent third party assessment and the inadequate due process. To better counter these obstacles, practical efforts have to be made, including reinforcing the understanding of competition policy, adopting the fair competition review progress into officials’ political achievements’ assessment, navigating the supply-side structural reform by the competition policy, legalizing the fair competition review, connecting the fair competition review and the budget laws, drafting the *Rules for the Implementation of Fair Competition Policy Review* and strengthening AML enforcement forces as well.

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The Changing Landscape of Vertical Restraints in China

By Stephen Crosswell, Tom Jenkins & Wenting Ge

Introduction

This article examines China’s evolving approach to vertical agreements, from the perspective of both regulators, the National Development Reform Commission (NDRC) and the State Administration for Industry and Commerce (SAIC), and the Chinese courts.

Resale price maintenance (RPM) remains a high enforcement priority for the Chinese regulators, in particular the NDRC (which has responsibility for policing price related infringements of the Anti-Monopoly Law). The NDRC’s decisional practice to date broadly treats RPM as a per se illegal restraint.

However, the courts in a number of decisions have applied a rule of reason analysis. At the same time, guidance is starting to emerge as to how other vertical restraints—in particular, territory and customer restraints—will be assessed in China.

Resale Price Maintenance

The treatment of RPM is one of the most controversial areas in competition law globally. Many economists, together with the business community, have tended to oppose a strict, or per se, approach to RPM. Economists recognize that RPM may, in certain circumstances, restrict competition. But, at the same time, they have for many years argued that RPM is, usually, benign and often procompetitive. As a result, most economists argue that RPM should not be per se illegal but should be analyzed under a “rule of reason” approach, which allows weighing of potential anticompetitive effects against potential efficiency benefits of the restraint.

Article 14 of China’s Anti-Monopoly Law (AML) applies to vertical relationships, i.e., agreements between business operators at different levels of the supply chain.1 The provision expressly prohibits “fixing the price for resale to a third party” and “restricting the minimum price for resale to a third party.”2 The wording of Article 14 points towards a per se illegality standard, analogous to the position taken by the European Commission3 and EU courts.4

Since 2013, the NDRC has launched a series of high-profile enforcement actions against RPM practices. In its early RPM cases, the NDRC was vague on which doctrine—i.e., “per se illegal” or “rule of reason”—should be used to assess the legality of RPM. In early 2013, the NDRC’s Sichuan provincial bureau (SDRC) announced its decision to impose a fine on the

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1 See Wu Zhenguo, Perspectives on the Chinese Antimonopoly Law, 75 ANTITRUST L.J. 81 (2008) (“Article 14 of the AML includes regulations on vertical monopoly agreements.”).
famous Chinese liquor company Wuliangye for RPM. In the decision against Wuliangye, the SDRC articulated the basic elements of competitive analysis, including intraband/interband competition, as well as the effects on consumer welfare. Wuliangye’s strong market position was also considered in the analysis of anticompetitive effects. It therefore seems that NDRC adopted the “rule of reason” approach in the Wuliangye case. However, the chosen mode of analysis became less clear in later enforcement decisions. An NDRC official observed that the agency’s approach towards RPM was neither “per se illegal” nor “rule of reason,” but rather “prohibition plus exemption.” This approach appears similar to the EU position, where RPM is treated as a restriction of competition by object, but also subject to the possibility of individual exemption where the parties can show countervailing efficiencies. To date, we have not seen an efficiencies defense argued successfully before the NDRC (nor, indeed, have such arguments been accepted in the EU).

Since the Wuliangye decision, the NDRC has issued eight prohibition decisions on RPM. In most of the decisions, RPM was found illegal by simply referring to the violation of Article 14 without further analysis, which suggests application of the “per se illegal” approach.

In contrast to these recent NDRC decisions, the Chinese courts have shown themselves willing to take a more nuanced approach. In Rainbow Medical Equipment and Supplies Co v Johnson & Johnson Medical (which concerned RPM provisions in Johnson &Johnson’s distribution arrangements in China), the courts applied a rule of reason approach when they concluded that the plaintiff had failed to show that the RPM in question had anticompetitive effects. The Shanghai Higher Peoples’ Court sets out the following framework for dealing with RPM cases:

- Whether there is sufficient competition in the relevant market (primary condition);
- Whether the defendant has a strong market position (prerequisite and basis);
- Motivation of the defendant to conduct RPM;
- Effects of RPM on competition both anticompetitive and procompetitive effects.

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6 Id.
7 Id.
9 EU Vertical Guidelines, supra note 3, ¶ 225 (suggesting that RPM may be defensible in the context of a new product launch, or for a limited duration in the context of a franchise arrangement).
10 Rainbow Medical Equipment and Supplies Co v Johnson & Johnson Medical, Shanghai First Intermediate People’s Court, available at http://wenshu.court.gov.cn/content/content/?DocID=effe7905-b647-11e3-84e9-5cf3fc0c2c18&KeyWord=邦 (in Chinese).
11 Id.
12 Id.
In a more recent decision, the Guangdong Intellectual Property Court dismissed a claim by a local home-appliance retailer against GREE, a large Chinese manufacturer of air-conditioning units. The retailer had sought damages for unlawful RPM. The court found that the upstream market for the supply of air-conditioning units was sufficiently competitive and that there was no evidence that the restraint eliminated or restricted competition vertically or horizontally.

Given the stance of the NDRC, the compliance message in China must be that RPM remains high risk, with the NDRC generally unlikely to be persuaded by efficiency arguments. The apparent difference in approach as between the regulators and courts is nonetheless interesting. It remains to be seen how this tension will be reconciled. In its most recent high-profile decision, the NDRC did analyze the structure of competition on the relevant market, suggesting that the party’s position on the market as against competing manufacturers was a relevant consideration. It remains to be seen whether parties can successfully argue efficiency defenses in NDRC investigations into RPM, including in areas such as franchise pricing, where there is, as yet, no guidance in China.

RPM and Intermediaries/Agents

There remains ambiguity about the treatment of intermediaries, e.g., where a distributor is responsible for logistical support (such as warehousing, delivery, invoicing) but where negotiations are handled directly between the supplier and the end customer. Under the EU rules, a supplier is only permitted to impose price controls where the intermediary meets the criteria for a “genuine agent,” i.e., where the intermediary assumes no material or financial risks. In March 2016, the NDRC published for comment draft Guidelines on Antimonopoly in the Automobile Industry (Draft Auto Guidelines) which suggest that a more flexible test may be appropriate in China, in that, where the distributor intermediary is only involved in the sales process in a limited way (such as vehicle handover, payment collection and issuance of invoices), the OEM may lawfully control the resale price at which the intermediary sells to the end customer. If given a broader application, this position may prove helpful to businesses, as it avoids the relatively strict criteria applicable to the EU concept of genuine agency.

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13 See Dongguan Hengli Guochang Electrics Co. v. Dongsuan Sheng Shi Xin Xing Gree Trade Co., available at http://wenshu.court.gov.cn/content/content?DocID=f9d94f5a-e0b9-4720-8789-a7f50c3eb9a&KeyWord=%E6%A8%AA%E6%B2%A5%E5%9B%BD%E6%98%8C (in Chinese).
14 Id.
15 Id.
17 EU Vertical Guidelines, supra note 3, ¶ 13 (“The determining factor in defining an agency agreement for the application of Article 101(1) is the financial or commercial risk borne by the agent in relation to the activities for which it has been appointed as an agent by the principal. (1) In this respect it is not material for the assessment whether the agent acts for one or several principals. Neither is material for this assessment the qualification given to their agreement by the parties or national legislation”).
Other Vertical Restraints

Article 14 of the AML does not explicitly address other vertical restraints, such as territorial and customer restraints, and no guidance was issued on vertical restraints when the AML came into force. However, the Draft Auto Guidelines being developed by the NDRC appear to shed some light on this issue.19 In the Draft Auto Guidelines, the NDRC proposes that territory and customer allocation be treated as generally unlawful unless the parties can show that the restriction fulfils the conditions of Article 15 of the AML.20

The Draft Auto Guidelines go on to distinguish between:

- The restriction of active sales into a territory/customer group reserved to another dealer. The draft Guidelines suggest that this is likely to be exempted under Article 15, owing to the need to protect investments made by dealers in establishing the brand image of the supplier, provided that the supplier does not have significant market power (25-30% market share).
- The restriction of passive sales, which will generally not fulfil the criteria of Article 15, and therefore be unlawful.21

This appears very much in line with, and influenced by, the EU law position on territory/customer restrictions.

Although the official version of the Guidelines has not been released yet, the draft suggests that NDRC tends to regard territory/customer allocation as illegal in the auto industry. An important question is whether this approach is to be limited to the auto industry. The NDRC has taken at least one decision in the medical devices sector that referred not only to RPM but also to territorial restraints imposed on distributors, suggesting that such restraints are going to come under increased scrutiny.22

What is to Be Expected?

The Chinese government is currently focusing on distribution-related concerns in various industries to build a single market across China and to establish fair and organized market competition. As the Chinese economy increasingly moves from an export led to a domestic growth driven phase, such public policy concerns may lead to more intense focus on vertical restraints. Traditionally, strong efficiency arguments have been available as businesses developed their distribution networks in China. But we are seeing increasing focus on clearing away restraints in building a single market.

19 Id.
20 These include improving operational efficiency; enhancing the competitiveness of small and medium undertakings; promoting various public interests such as conserving energy, protecting the environment, and providing disaster relief; mitigating severe decreases in sales or overstocking during economic recession; and protecting “the legitimate interests of international trade and foreign economic cooperation.” To benefit from Article 15, the agreement must also not severely limit competition and must allow consumers a fair share of the relevant efficiency benefits stemming from the agreement.
21 See Draft Auto Guidelines, supra note 18.
22 See NDRC Press Release, supra note 16.
The State Council published the 13th Five Year Plan on market supervision on January 12, 2017 (the Plan). The Plan highlighted that, for the purpose of building a fair market, it is important to build up a “nation-wide single market.” Among other things, territorial restraints that may damage the single market and fair competition should, according to the State Council, be removed.

It is also significant that EU competition law has played an important role in the development of the AML thus far, particularly in so far as the NDRC and the SAIC are concerned. The main policy goal behind the EU approach to territorial and customer restraints has been to break down national barriers and to engineer a European single market. China’s economic history is quite different and so it is starting from a different place, but it appears that the NDRC and the SAIC, in implementing the goals of the Plan, may seek to expand policing of distribution arrangements to a EU-style approach to territory and customer restrictions. This is likely to start in industries already subject to a high degree of antitrust scrutiny, e.g., automotive, pharmaceuticals, medical devices. Businesses in these sectors should review their distribution agreements, in particular to the extent they impose passive sales restrictions.

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24 Id.

25 Id.
Legal Update: China’s Cybersecurity Law
What are the legal aspects of the new law that might impact businesses in China?

By Wei Chen

After issuing three drafts for public comments during the previous two years, the Standing Committee of the National People’s Congress approved the Cybersecurity Law on Nov. 7, 2016, and it will come into force on June 1, 2017. But what will be changed in terms of cyberspace security in China after the final release of this long-awaited law?

With 79 articles, the law has a broad regulatory scope over the area of cybersecurity, including network operation security, network data security, network information security, “critical/key information infrastructure” security, and alarm and emergency response systems. The law aims to safeguard the sovereignty of national cyberspace and Chinese national security. The law establishes a comprehensive regulatory regime for cyber security, creates or formalizes legal responsibilities for “network operators” and “network service providers,” and develops regulatory supervision in a more systematic way.

The law will regulate all network services and activities within China, including construction, operation, maintenance, and usage of networks. “Network” refers to any system that can be used for information gathering, storage, transmission, exchange and processing. All network operators (including owners, administrators and service providers) in China, domestic and foreign, will be regulated by the new law.

What are the relatively new aspects under the law?

1. Network operation security One of the focal points of the law is to set up an all-around network operation security system, including:

   a. **Graded network security protection system**: The law establishes a “graded network security protection system,” but doesn’t offer details about how it will be implemented.

   b. **Personal identification**: The law restates that network operators should identify all personal users when providing network access and services.

   c. **Cooperation with law enforcement**: The law requires network operators to provide technical support and assistance for public security investigations and actions.

   d. **“Key network equipment and specialized cyber security products”**: All “key network equipment and specialized cyber security products” should be certified by qualified entities in accordance with the relevant national standards before being sold, and the law defers to the offices of the Cyberspace Administration of China (CAC), together with other government authorities, to issue a catalog of the “key network equipment and specialized cyber security products” separately.
e. **Critical information infrastructure operators.** The concept of “critical information infrastructure operators” (CIIOs) is introduced as an important element under the law and drew a lot of attention due to its broad scope of coverage and additional regulations. CIIOs are defined as important sectors and fields – such as public communications and information services, energy, transportation, water conservancy, finance, public services, e-government affairs and other information infrastructures – that if compromised could jeopardize national security, national welfare and public interests. The State Council will issue implementing rules later which are expected to clarify the “specific scope” and “security protection measures” for CIIOs.

Among all the additional requirements for the CIIOs, the following are worth highlighting:

a. **Data localization:** Personal information and other important data gathered or generated by the CIIO in mainland China should be stored in China, unless it can pass a security assessment run by designated agencies. However, the definition of “other important data” remains unclear.

b. **National security review:** If procurement of network products and services by CIIOs may impact national security, such procurement should go through a government national security review process.

c. **Inspection and assessment:** CIIOs should have their network security stability and potential risks inspected and assessed on an annual basis.

d. **Support government’s action:** The offices of the CAC and other government authorities have the right to examine the security risks of CIIOs and host emergency response rehearsal on a regular basis, and CIIOs should cooperate with such government actions and provide technical support in emergencies.

e. **Monitoring system and emergency response mechanism** By naming the offices of the CAC as the leading authority, the law provides that the state will establish the cybersecurity monitoring system, information reporting regime, risk assessment and emergency response mechanism.

To ensure national safety and public order and to handle a significant and urgent social security event, the government may impose certain temporary methods to restrict network communications within specific regions, following the decision or approval from the State Council.

**What other aspects are covered under the law?**

Personal data protection is another important aspect under the law. In line with current regulations, the law redefines personal data and restates restrictions to collect, use and disclose any personal data. In short, any personal data should be collected and used with the prior consent and within the limited scope to suit the network operators’ services. No disclosure, tampering or destruction of personal data is allowed unless it has been properly anonymized. A notable clarification under the law is that any data with personal identification information
removed and un-restorable will no longer be deemed as personal data and accordingly, will not be subject to the regulations and restrictions upon the personal data.

Internet censorship is a crucial part of cyberspace supervision in China. The law restates that network operators should enhance their supervision over content posted by the users by blocking or deleting illegal content, ceasing service provision, and reporting to the relevant authorities.

**Penalties for violations**

The Cybersecurity Law specifically imposes a range of penalties for violations with relatively detailed descriptions, including monetary fines. The law also establishes a credit system for the network operators and any violation of the law by a network operator will be recorded in its “credit archive” and announced publicly. Lastly, a new provision targets foreign hackers by codifying that foreign agencies, organizations or individuals that endanger China’s critical information infrastructure are subject to asset seizures and other punitive measures.

**What’s next?**

Although the law has been approved, certain aspects require further elaboration through implementing rules or interpretation by the authorities. More importantly, the law delivers a message to everyone relating to cyberspace that China will safeguard cybersecurity as part of national security.

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Employers Get a Break on Labor Disputes

By Liu Zhenghe and Samuel Yang

The unilateral termination legal system for employers affects employees’ rights of labor, employment stability and development, employers’ ability to operate autonomously, and the reasonable and orderly mobility of labor.

The system of unilateral termination in China has experienced two milestones; one was the “employer friendly” unilateral termination under the Labor Law of the People’s Republic of China implemented in 1995, and the other was the “employee friendly” unilateral termination under the Labor Contract Law of the People’s Republic of China implemented in 2008.

The termination system for labor contracts was quite strict under the Labor Law legal system, and the conditions, procedures and compensation of termination were all strictly stipulated under the law. However, there was no limit to the expiry of a fixed-term labor contract. Therefore, an employer often preferred to utilize short-term labor contracts to avoid the strict termination system.

The Labor Contract Law, however, included new clauses for mandatory conclusion of an open-ended labor contract and financial compensation based on the termination of a fixed-term labor contract. As a result of the Labor Contract Law’s implementation in 2008, there was no way for an employer to avoid the strict termination system.

Since the 2008 implementation of the Labor Contract Law, debate has raged regarding the law and if the system overprotects employees. The discussion on potential revisions of the Labor Contract Law was particularly fierce during 2016, but the revision of the Labor Contract Law has not been officially included in the National People’s Congress legislative planning.

Though the Labor Contract Law has not been revised, in some areas the referee criteria of labor arbitration and litigation have been changed. Recently, the Beijing Higher People’s Court and the Beijing Labor and Personnel Dispute Arbitration Committee jointly released the Explanation on the Application of Law in the Trial of Labor Dispute Cases (“Explanation”), in which there were many clauses that involved labor contract termination disputes. Overall, the Explanation did not change the fact that the termination system for labor contracts is quite strict under the Labor Contract Law legal system, but it did make some favorable provisions for employers on the referee criteria for labor dispute cases.

For instance, the employer’s burden of proof that the employee does not meet the conditions of employment is appropriately reduced in case of termination of the labor contract during the probationary period. If the employee has serious breaches of labor discipline or
professional ethics, even if the rules and regulations of the employer or labor contracts do not clearly define or stipulate such circumstances, the employer can still unilaterally terminate the labor contract.

In a case where the employer is deemed to have illegally terminated the labor contract and the employee insists on the resumption of the labor relationship, it points out the circumstances in which labor arbitration or litigation should adjudicate the labor relationship that cannot be resumed.

The changes to the referee criteria may indicate the direction of legal amendments in the future. Even without a fundamental revision of the basic legal system and relatively relaxed restrictions on employers, the changes seem likely to help appropriately reduce the risks and costs to employers of unilateral dismissal.

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