China in focus

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Contact

For further information, please contact:

Peter Corne
Managing Director, Shanghai
+86 21 6137 1001
petercorne@eversheds.com

Steve Yu
Partner
+86 21 6137 1002
steveyu@eversheds.com

ANTITRUST ALERT

Chinese internet search engine Baidu cleared of abuse of dominance in China's second antitrust court decision

Beijing Court dismisses private antitrust action brought by Tangshan Renren Information Services against Baidu, a leading Chinese search engine. In imposing a high evidential burden for proving dominant market position, the decision sheds some light on how Chinese courts may define a relevant market and brings to an end a busy year for Chinese antitrust developments.

Peter Corne and Charlie Markillie, Eversheds LLP

Background

On December 23 2009 Beijing's No.1 Intermediate People's Court cleared internet search engine provider, Baidu Inc ("Baidu"), of an abuse of dominance by dismissing the latest private antitrust action brought under Article 50 of China's Anti Monopoly Law ("AML") by Tangshan Renren Information Service Company ("Renren").

Renren had claimed that a reduction of visits to its medical information website was caused by Baidu blocking its website from search results. According to Renren's figures, visits to the website had decreased dramatically from 2961 individual hits to only 701 individual hits in one day.

Renren alleged that Baidu had blocked its website from search results as a result of Renren reducing the amount of money it paid to Baidu for advertised services and, in turn, this amounted to an abuse of Baidu's dominant position in the Internet search engine market under Article 17 of the AML. Renren sought damages amounting to RMB1.1million and an injunction banning Baidu from blocking its website in the future.

Baidu admitted that it had blocked Renren's website, but argued that (i) it did not have a dominant position on China's search engine market; (ii) its search engine service is free to the public and therefore should be exempted from the application of the AML; and (iii) the actions it took in blocking Renren's website were justified under its published policy as the website contained a deliberately large number of "junk links".

Definition of Relevant Market

Following the first Chinese decision on abuse of dominance by the Shanghai No.1 Intermediate People's Court in Sursen v Shanda in October 2009, the Beijing court has taken a similar approach in requiring a high level of proof of a dominant market position and has used the opportunity to conduct a substantive analysis of how a "relevant market" and "dominant position" will be defined under the AML.

The court decided that the relevant market for determining whether Baidu had abused its dominant position would be "China's search engine market". The court decided that the market would be limited to the Chinese market as, due to the vast cultural and language differences with search engines operating outside of China, there is close substitutability only amongst Chinese search engine services. The court decided to limit the relevant market to "search engine services" rather than other types of internet related services (such as the on-line news services or the instant communication service) because the search engine market provides a number of unique services that cannot be substituted by other types of internet services.

Unsurprisingly, the court did not agree with Baidu's argument that antitrust law should not apply in this case because the search engine service is free to the public, as they also provide paid for services, such as sponsored links and advertisements.

Dominant Position

Article 19 of the AML states that a business operator may be presumed to have a dominant position if it holds a share of 50% or more of the relevant market. In order to prove that Baidu's market share exceeded 50%, and that the presumption of dominance would apply, Renren submitted one media report and one press release published by Baidu that respectively stated that Baidu holds a market share of 65.8% and 70%.

Similar to the findings of the Sursen v Shanda decision, the Beijing court held that these media reports are not sufficient to prove Baidu's market share as neither had any economic analysis or explanation of how they arrived at their figures for market share and it was unclear what they were holding to be the "market" i.e. was it "China's search engine market" (as defined by the court) or an alternative definition. The court held, therefore, that the presumption of dominance in Article 19 of the AML would not apply.

The court also considered the factors set out in Article 18 of the AML when assessing whether Baidu held a position of market dominance. These factors include the market share of the company, competitive advantage, the company's financial and technological capacity and the difficulty or ease of entry into the market.

This is notable because it shows that the court imposes a high evidential burden for proving the existence of a dominant position under the AML and that it will only take into account claims of market share if they are accompanied by sound economic market analysis and explanations.

Abuse

The court also agreed with Baidu's argument that it was justified in blocking Renren's website as the website contained a large number of 'junk links' and Baidu's policy of blocking such websites was notified to Renren before the website was blocked and is enforced equally against all websites.

Therefore, the court found that Baidu had not abused a dominant position within "China's search engine market".

Such case examples are particularly welcome against the background of reports of increased "information gathering" activity conducted by Chinese enforcement authorities.

Review of 2009

The Baidu decision comes at the end of an extremely busy year for Chinese antitrust developments. The first full year of the AML since its enactment in August 2008, 2009 has seen a number of key decisions and developments for Chinese antitrust law. We highlight a number of the key events below:

1. Coca-Cola/Huiyuan deal rejected by MOC: March 2009

On 18 March 2009, China's Ministry of Commerce ("MOC") formally rejected Coca-Cola's proposed US$2.4 billion acquisition of China's Huiyuan Juice Group, the country's leading pure juice manufacturer.

The planned acquisition was potentially the largest ever foreign takeover of a Chinese company and was the first major acquisition to be blocked by MOC for being anti-competitive under the AML.

The decision was criticised by some for its failure to provide any clear indication of the justification for the decision and for only containing a brief 1,400 word announcement which lacked any in-depth antitrust analysis.

Many were also concerned that MOC may have put local protectionism ahead of antitrust theory and that MOC had missed an opportunity to give valuable guidance on how it would handle foreign acquisitions of Chinese companies.

2. Mitsubishi/Lucite deal approved conditionally: April 2009

On 27 April 2009 MOC announced that it had approved the US$1.6 billion takeover of UK acrylic manufacturer Lucite International Group by Mitsubishi Rayon, subject to several significant conditions.

MOC concluded that the deal would lead to certain "negative impacts", both horizontally and vertically, due to a combined market share of 64% following the merger and would have the effect of eliminating or restricting competition unless the conditions were complied with.

MOC imposed conditions that required Lucite to sell half of its annual methyl methacryalte (MMA) monomer production capacity to a third party within six months for a period of five years. If the divestment was not completed within six months, then the MOC retained the power to unwind the transaction and arrange for the sale of 100% of Lucite China to a third party. MOC further required both Mitsubishi and Lucite to continue to operate their businesses separately until the divestment was complete and that, following the merger, the merged entity must not acquire any other MMA producer or establish any production plants for MMA in China.

3. SAIC published procedural rules for antitrust investigations: June 2009

On 5 June 2009, without making a draft consultation document available for public comment first, the State Administration of Industry and Commerce ("SAIC") published the "Procedural Rules on Investigation and Sanctions by the Administration for Industry and Commerce on Monopoly Agreements and Abuse of Market Dominance" (the "Monopoly and Dominant Position Rules").

The first procedural rules published by China following the promulgation of the AML, they focused on the investigative powers that SAIC may use when examining possible monopoly agreements and the sanctions that they may impose under the AML.

The rules state that investigators from SAIC or its designated Provincial-level branches, may enter business premises or other places relevant to the suspected business, question the management or other interested parties or related individuals, read and make copies of any relevant documents, seal and seize any relevant evidence and investigate company bank accounts.

In addition to the on-site investigations, investigators may request a suspected company to supply in writing a broad range of information on its business activities, including accounts for the last three years and also respond to any questions raised by the investigators.

The rules also dealt with the penalties that SAIC may impose on companies if found guilty and the potential of a reduction in penalty if a company actively reports a monopoly agreement or provides information on the existence of a monopoly agreement.

So far SAIC has only carried out two low-profile investigations into the Chinese operations of one European-based multinational company and one major State-owned company but have not published any details of their findings.

4. GM/Delphi merger approved subject to conditions: September 2009

On 28 September 2009 MOC published their decision to approve the US$1.75 billion merger between General Motors (GM) and Delphi Corporation, a previously bankrupt car-parts manufacturer, subject to the companies completing several required conditions.

Despite the deal being cleared unconditionally in the EU, MOC identified four areas of concern arising out of the merger following consultations with car manufacturers. These included worries that the combined entity would be too powerful for local car manufacturers to compete with and that Delphi might pass confidential information regarding other manufacturers to GM.

The conditions imposed by MOC on the merger included requirements that Delphi will continue to supply other domestic car makers without discrimination and will not increase switching costs for other manufacturers. GM were required not to seek information from Delphi regarding other domestic manufacturers and to continue to comply with multi-sourcing and non-discrimination principles when purchasing automotive parts. Both parties are required to make regular reports to MOC about their compliance with the conditions.

5. Pfizer/Wyeth deal approved subject to divestment conditions: September 2009

The day after its decision on the GM/Delphi acquisition, MOC announced a further conditional clearance in the $68billion acquisition of drug maker Wyeth by Pfizer, Inc.

MOC determined that the merger would have an adverse effect on competition in the market for the vaccine for mycoplasmal pneumonia in swine in China, as the combined market share in this sector would be 49.4% following the merger, significantly higher than the next competitor.

MOC therefore required that Pfizer should divest its Chinese swine mycoplasmal pneumonia vaccine business, including IP assets, to an approved third party within six months of the merger. Pfizer are also required to provide reasonable technical support to the purchaser of the business for up to three years. If Pfizer fails to find a purchaser then MOC have the power to appoint a trustee to dispose of the business with no reserve price.

6. China Mobile Settles Private Antitrust Action – increase in Article 50 Actions: October 2009

2009 saw a large number of private litigation cases brought under Article 50 of the AML. A number of these private actions have been brought by both individuals and small businesses against large Chinese companies such as Shanda Interactive Entertainment, Sinopec, China Netcom and Chonqing Insurance.

On October 23 2009 the Beijing Doncheng People's Court announced that the private AML action brought by lawyer Zhou Ze against China Mobile, China's largest mobile

network operator, for abuse of dominance and unlawful price discrimination had been settled outside of court.

In what was a small action, Zhou Ze sought damages of RMB1,200 for payments he made as part of a phone rental fee. China Mobile agreed to pay Mr Zhou RMB1,000 to withdraw the claims.

The decision of China Mobile to settle this case before it reached court shows that large companies are reluctant to become "test cases" for the AML in the interim period before guidance on the operation of the law works is released. If found guilty by the court, China Mobile could have been fined up to 10% of its turnover and could also have been subject to a regulatory investigation.

7. MOC clears Panasonic and Sanyo Merger but requires divestments outside of China: October 2009

On 30 October 2009 , MOC announced that it conditionally approved the US$8.87 Billion acquisition of Sanyo Electronic Co., Ltd ("Sanyo") by Panasonic Corporation ("Panasonic").

The proposed deal triggered pre-merger filing obligations in major jurisdictions around the world and the deal had received conditional clearance from the Japanese and European competition authorities, however, compared to other jurisdictions, the conditions imposed by MOC have significantly more far-reaching effects.

MOC identified that the merged entity would hold high market shares on three battery-product markets and that the merger could potentially eliminate or restrict competition.

MOC found that the merged entity would hold a 61.1% share of the Chinese market for button batteries and 46.3% for civil batteries. MOC felt that, due to the lack of competitors and its high market share on these markets, the merged entity would be able to raise its prices unilaterally following the merger.

In the vehicle battery market, Panasonic Energy Co., Ltd (PEVE), a joint venture between Panasonic and Toyota, held a market share of 77% and its only competitors were Panasonic and Sanyo. MOC felt that the acquisition would further reduce competition on the market and that Panasonic would be able to use its position in PEVE to further influence competition in the market place.

MOC required that Sanyo and Panasonic sell both their button and civil battery businesses to a third party within six months of the acquisition and if no buyer is found within that time frame MOC will appoint an independent trustee to transfer the business to an independent third party.

In relation to Panasonic's vehicle battery business, MOC required that they transfer their business located in Japan to a third party approved by MOC within six months of the acquisition otherwise MOC would transfer the business to an independent third party. MOC further required that Panasonic reduce its shareholding in PEVE from 40% to 19.5% following the acquisition, Panasonic must waive its right to appoint PEVE directors and vote in PEVE's shareholder meetings and PEVE must remove Panasonic from its company name.

With this decision, being the first time that MOC have compelled disposals outside of China, MOC has demonstrated that it is becoming increasingly sophisticated in its use of remedies for merger cases and that it will not refrain from intervening in deals between two foreign companies with presences in China.

The extra-territorial reach of some of the divestment obligations placed, whilst perhaps concerning at first glance, also suggests that MOC recognises that geographic markets can be defined more widely than PRC, which is a healthy signal for those businesses looking engage in merger transactions in China.

Looking ahead to 2010

Most of the cases highlighted above involve merger approvals and are all dealt with by MOC, who has been very active in both approving mergers – it estimated in July that it had approved over 50 cases this year alone – and producing several procedural guidelines throughout the year.

MOC has shown that it is able to stick to its time restrictions and will often come to a decision prior to the final deadline. In its published decisions (some of which are highlighted above), MOC is showing that it has listened to early criticism that it received and is taking a more thorough and detailed approach to its decision making. MOC's actions also show that it is prepared to use its powers to impose both behavioural and structural conditions and to prohibit mergers where it considers appropriate.

Whilst MOC is still feeling its way through the early stages of AML enforcement, we expect that MOC will continue to evolve and will continue to impose a variety of conditions and remedies. Western firms should be aware of the potential of any merger requiring clearance in China and the possible implications of this.

Compared to MOC, the two other bodies responsible for enforcement of the AML, SAIC and the National Development and Reform Council ("NDRC"), have both been considerably quieter.

In May, SAIC, the body responsible for handling cases in relation to abuse of dominance and administrative monopolies, published two important, substantive draft implementing measures on both the abuse of a dominant market position and the prohibition of monopoly agreements (it is likely that these will become law in the first few months of 2010). It followed these with the publication of its procedural rules for investigations into abuse of dominance and monopoly agreements (see above).

Meanwhile, the NDRC, which deals with price-related antitrust cases, has issued draft guidelines on price monopoly regulations.

We predict that following the promulgation of the investigation procedures and the other draft measures becoming law, 2010 will see the first wave of antitrust investigations in China by SAIC and the NDRC. On-site investigations, dawn raids and substantial fines are a real possibility for businesses found to be abusing a dominant position or engaging in a monopoly agreement.

Therefore it is important for all companies engaged in business in China to ensure compliance with the AML and to take a pro-active approach in identifying and managing the antitrust risks of its business operations in China.

Peter Corne is the Managing Director of the Eversheds LLP Shanghai Office. Charlie Markillie is a solicitor in the Leeds Office of Eversheds LLP specialising in Competition Law and has spent six months on secondment in the Shanghai Office. Eversheds LLP was named Antitrust Firm of the Year – PRC Region in 2009 by leading regional legal publication Asian Council.

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