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A red wave rising

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Over the past year, antitrust enforcers in China have risen from a five-year incubation to bring a spate of cases that have riled foreign officials and Western business groups over a host of concerns, from timing issues to outright intimidation. Those officials and business groups have asked China to alter the way it treats foreign businesses, but enforcers in Beijing appear set on imposing their own brand of antitrust enforcement. **Ron Knox** reports

It was just after noon at Georgetown University's annual antitrust conference, and amid the clanging cutlery of dozens of business lunches, Edith Ramirez, the chairwoman of the US Federal Trade Commission, stood behind a podium and delivered the sort of state-of-the-agency speech common to these kinds of affairs. The topic this time: technology and patents, the bedrock of the FTC's current competition caseload. Among antitrust wonks, technology issues are a well-worn topic, and the chairwoman's speech was standard fare for anyone who

has paid attention to the work of the agency over the past several years.

Until she mentioned China.

Midway through her speech dedicated to issues in the US, Ramirez shifted her focus to a recent spate of Chinese antitrust cases. She broached recent media reports that suggested Chinese enforcers were targeting standard-essential patent holders over competition concerns – a topic familiar to Ramirez and other enforcers in the US, Europe and elsewhere. But rather than attacking patent owners for their apparent abuses, Ramirez said, it appeared for the all the world that the Chinese investigations were fuelled instead by unhappiness with the prices charged to Chinese tech companies for access to those patents.

“I am seriously concerned by these reports, which suggest an enforcement policy focused on reducing royalty payments for local implementers as a matter of industrial policy, rather than protecting competition and long-run consumer welfare,” Ramirez told the crowd. The cutlery quietened.

Ramirez’s statements – the harshest yet by one of China’s international antitrust counterparts – mirror widespread Western backlash against a host of new Chinese competition cases that appear to be aimed squarely at foreign companies and the prices they charge Chinese businesses.

The investigations, which first came to light early this year and have grown in number and severity since, follow on the heels of some significant growth within China’s three antitrust enforcers. Six years into the lifespan of China’s Anti-Monopoly Law (AML), the agencies – the Ministry of Commerce, the National Development and Reform Commission and the State Administration of Industry and Commerce – are well-staffed, secure in their legal footing and have begun bringing complex cases outside of merger enforcement that beam light on the country’s enforcement priorities.

Since June, the country has brought a dozen cases alleging some kind of anti-competitive behaviour. Those cases are myriad. In February, the NDRC held a press conference in Beijing announcing that it was investigating computer chip maker Qualcomm for abuse of dominance and discriminatory pricing for allegedly charging Chinese companies more than their foreign counterparts. After a few relatively quiet months, SAIC officials on 4 August raided four Microsoft offices in China over the interoperability of its software, and the following day, the NDRC confiscated documents and files from the offices of carmaker Mercedes in another pricing-related probe.

In the weeks that followed, Chinese antitrust actions splashed the headlines once every few days. More raids at Microsoft. Audi, BMW and Chrysler targeted in the auto parts investigation. Meetings with top officials at Qualcomm.Onerous deadlines for Microsoft to answer the enforcer’s questions.

“For anyone who hasn’t noticed yet, Chinese behavioural enforcement is up and running,” said Alex Potter, a partner at Freshfields Bruckhaus Deringer who spent years in China when the AML first took effect.

The fresh wave of antitrust investigations against foreign companies spurred quick and sometimes severe reactions from foreign governments and business groups, many of which had long harboured doubts about the fairness of Chinese antitrust probes and the due process afforded to companies under the microscope of the law.

In the years since the AML was enacted, US and European companies have wrung their hands over how and why China was bringing antitrust cases. Of the nearly 870 mergers Mofcom has reviewed from 2009 through the middle of this year, China has blocked or altered only 25 of those – a rate that dovetails with global enforcement standards. But all of those deals have involved at least one foreign company, and either a foreign takeover of a Chinese brand or a deal that would threaten the power of domestic business.

The evidence used to reach decisions can also be deeply murky, observers familiar with the agencies say.

Five years in, business groups in the US and Europe have also chastised China for what appear to be systemic shortcomings in the due process afforded to targets of its investigations. China’s merger review process has been among the slowest in the world since the AML was enacted. At least twice, Mofcom has taken more than a year to decide whether to clear or block a deal – an inordinate amount of time to wait for an enforcement decision. Foreign governments have also heard complaints over a myriad of other alleged due process shortcomings: opaque reasoning behind decisions, a lack of communication about why investigations are taking place, refusal to allow international lawyers to take part in a case and so on.

The evidence used to reach decisions can also be deeply murky, observers familiar with the agencies say. Even for the parties involved, it can be difficult to tell what evidence is being used against you and how the Chinese agencies are interpreting the facts of a case.

“Many times, we don’t know. Even when I was helping my client, as the party, we do not know during the process if the agency has an economic expert,” said Elizabeth Xiao-Ru Wang from Charles River Associates. When the agency does employ an economic expert in a case, they typically do not speak to the defendant’s expert, maintaining the kind of uncertainty in the agency’s decision-making that rattles the business community’s nerves.

"Do we even see the same facts? And if we don't, where are the differences?" Wang asked. It's far easier for companies to understand a difference in facts than it is to try to judge cultural and economic differences, she said. But without more transparency, it will remain unclear what the actual differences are.

Sources involved in Chinese antitrust cases, along with published press reports, tell a much darker story about how investigations in China proceed. At the earliest stages, there is intimidation, uncertainty and confusion as the authorities are extremely adversarial from the off.

One China-based antitrust lawyer tells an extraordinary story of a dawn raid in which the NDRC officials on site refused to divulge any information about why they were there, merely saying they needed to confiscate all relevant data. When counsel asked how they were supposed to distinguish pertinent information when they had no idea what the company had allegedly done, the repeated response was: "You're the one being investigated, you should know what you've done." Nothing more.

Face-to-face meetings can often become hostile and aggressive, according to reports, with the agencies focused on eliciting confessions and using threats of arrest to intimidate companies. InterDigital, which bowed to NDRC pressure over the licensing of its standard-essential patents in May, declined to send executives to China for meetings with officials because it feared they would be arrested. The company's chief executive, William Merritt, said in December that he did not feel comfortable sending company representatives to NDRC meetings when they were "accompanied by a threat to the safety of our executives". InterDigital only met with the NDRC after the agency assured the company it would not arrest its employees.

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Chinese lawyers are treated particularly harshly in meetings, according to sources and reports. One source tells GCR that Chinese lawyers are called traitors in meetings and are pressured to stand down in their support of foreign clients. Lawyers are threatened with being banned from meetings, according to press reports, stifling their ability to advocate.

Some Chinese lawyers with good enforcer relationships can get better access and have their voices heard to a certain degree. But many say they still need to tread carefully, and that proposing a defence of your client can be seen as non-cooperation and a sign of disrespect, which could land you in hotter water.

The P3 shipping decision this June remains exhibit A of China's unconventional

approach to merger review. The three-way joint venture between shippers Maersk Line, CMA-CGM and Mediterranean Shipping Company gained quick approval from enforcers in the US and Europe; the deal did not even merit an investigation in the EU. But after being asked to file in China, Mofcom officials questioned how the deal would affect the local market. Proponents believed the venture would have created efficiencies ultimately benefiting Chinese importers and exporters that local shipping companies would have struggled to replicate.

Sources said at the time that the country's powerful shipping lobby bent Mofcom's ear about how the deal would affect the locals. During the probe, there was little dialogue between the two sides, other than Chinese officials flatly describing their concerns about the deal and asking the companies how they planned to solve them. Foreign lawyers couldn't sit in meetings with Mofcom. When the companies did submit potential solutions to the problems Mofcom identified, they were rejected just as quickly.

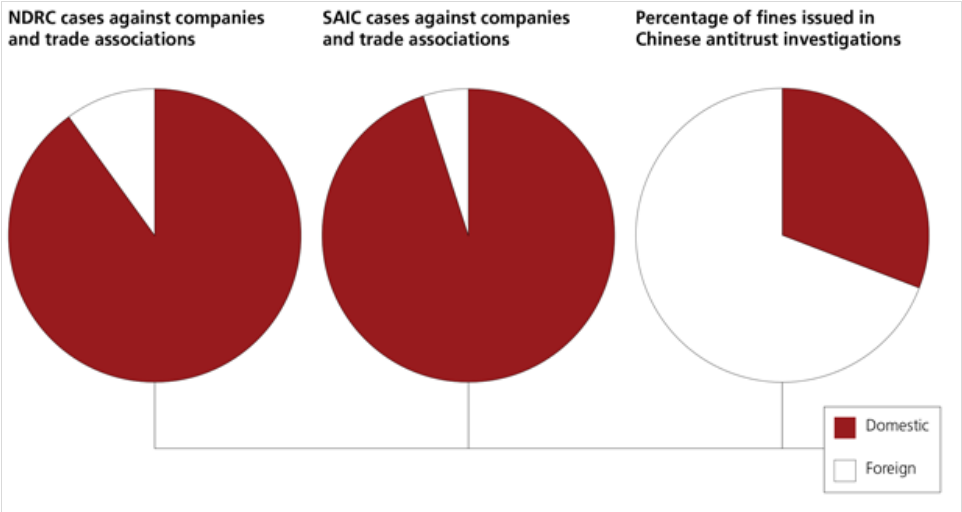
Mofcom elected to block the venture, saying the deal would have given the three shippers undue market power. Mofcom said they had secured the help of an independent economics expert who examined the market, including constructing HHI market concentration numbers as a result of the deal. Although the companies were allegedly never shown those numbers, they chose to back out of the venture to preserve their Chinese business, which remains in place. For observers, the investigation and the country's track record in takeovers has smacked of protectionism since the law's earliest days.

"The authorities have decided that they need prices lower and the AML is a mechanism for achieving this," says one senior China-based lawyer.

The new spate of investigations amplified all of these concerns and others. To many, Chinese enforcers appeared to target foreign firms solely because of the prices they charged – either for real goods, as in the car industry investigations, or for access to their intellectual property, as appears to be the case in the Microsoft and Qualcomm probes. For months, Qualcomm officials complained that they had no clue what the investigation was even about.

In the wake of the new investigations, several business groups have spoken out, both publicly and privately, about what they believe is a pattern of unfair treatment of foreign businesses. In a statement, the Chinese American Business Council, members of which include dozens of major US companies and law firms, says that, "while both foreign and domestic companies have been targets of monopoly-related investigations, in recent months foreign companies appear to have come under increasing scrutiny by enforcement agencies" in China.

In a study released alongside the statement, the business council reported that while only a fraction had ever been the target of a Chinese investigation, 86 per cent of its membership said they were at least somewhat concerned about China's enforcement of its competition law.



The European Union Chamber of Commerce in China in September criticised the Chinese state for creating an “unfair business environment for private and foreign companies”. Jörg Wuttke, the head of the chamber, urged the country to avoid policies and actions that continued “to afford the state sector a leading and dominant position, as well as continued protectionist inclinations.” The US Chamber of Commerce, meanwhile, reached out privately to Secretary of State John Kerry and Jack Lew, the Treasury secretary, complaining about the apparent focus on foreign companies in China’s antitrust investigations.

That pressure and more general concern over the investigations led Lew to send a letter to Chinese Vice Premier Wang Yang earlier this month, voicing the US government’s concern about the fairness of, and motivation behind, China’s new, aggressive antitrust investigations. According to press reports, Lew warned Yang that the foreign focus of the investigations could chill relations between the two countries and devalue foreign intellectual property.

It’s unclear what effect, if any, that political pressure will have on the Chinese regime and the status of its myriad ongoing antitrust cases. Companies continue to be hit with fines – on 12 September, the NDRC fined Audi and Chrysler a combined €35 million for their alleged role in the aftermarket auto parts cases – and the Qualcomm decision, in which fines could reportedly reach €1 billion, remains pending.

But some point to the NDRC’s recent disclosure of its Domestic Car Insurance cartel case as a sign that it is perhaps reacting to the international clamour. The matter was decided in December last year but in September became the first case in which the enforcer published detailed information about one of its investigations. The same process has just been applied in the Car Parts cartel probe, which saw record fines issued last month to 10 Japanese companies.

This is most certainly progress, observers say, as the level of openness is unprecedented. “Transparency reduces their discretion,” says one Beijing-based

source. “It means they cannot come up with a completely nonsensical theory of harm.”

However, several sources still remain cynical, saying the publishing of the cases was very timely given the attention on the NDRC’s practices, and whether anything changes in practice remains to be seen,

For its part, Chinese officials have shot back at claims that they unfairly target foreign companies. Officials from all three Chinese agencies say they are focused on harmful conduct regardless of where the company is based. Xu Kunlin, the director general for AML enforcement at the NDRC, has repeatedly defended his agency’s investigations and treatment of foreign companies. Even China’s premier, Li Keqiang, has said publicly that only 10 per cent of antitrust investigations in China involve foreign firms.

Still, foreign businesses and their advisers remain concerned, a fact reflected in the 14 per cent drop in foreign direct investment in China compared to this time last year. They see all-domestic Chinese mergers essentially being exempted from pre-merger notification requirements, while antitrust officials specifically ask foreign businesses to file their merger paperwork for examination. The stories of intimidation and due process shortcuts persist. And the hazy nature of enforcement in China has left some foreign practitioners questioning whether they’ve seen everything – or whether there are even more troubling cases and practices to come.

“We’re seeing what the AML now means in the non-merger context. And it’s troubling,” says one source, a former senior official handling international antitrust issues. “And we don’t know if what we’re seeing is everything. No one knows.”

GCR deputy editor Faaez Samadi contributed to this report