



# THE COST OF NON-COMPLIANCE

## Competition law in China

In this article, **Adrian Emch**, Partner at **Hogan Lovells** Beijing, looks at how to ensure competition law compliance in China: first, what rules need to be complied with and, second, what measures do companies need to take to ensure compliance?

**C**ompliance with Chinese law is important. Compliance with Chinese competition law is particularly important. Just look at the consequences in the case of a compliance failure: in 2014, US chipmaker Qualcomm was fined over EUR 810 million by the National Development and Reform Commission (NDRC) and, in 2016, the State Administration for Industry and Commerce (SAIC) imposed a fine of close to EUR 90 million on European multinational Tetra Pak – in both cases, for alleged infringements of the Anti-Monopoly Law (AML), China's main competition law.

### What rules to comply with?

Competition law, is a strange animal. Some of the rules can be quite complex. But other rules are very straightforward. In particular, the prohibition to engage in cartels with competitors is a very obvious offense, and many people (including non-lawyers) intuitively know that cartels are illegal.

But the cartel prohibition is broad. Cartel conduct does not only mean that competitors are prohibited from fixing prices, allocating territories or customers, and so on. The scope of the cartel prohibition has expanded over time, including in China, and in a certain way has lowered the thresholds for authority intervention. Today, exchanges of sensitive information among competitors—sometimes, only one-directional—can also be deemed to amount to cartel-like conduct, and be sanctioned in the same way. For example, in Europe, shipping companies were alleged to have breached competition law by “signaling” to each other their future prices by way of public announcements.

Beyond the relationship between competitors, competition law contains many rules which apply to a company's ‘vertical’ links: with suppliers, distributors, customers and so on. One no-go area for vertical links is resale price maintenance (RPM).

RPM exists where the supplier of a product sets the price (or minimum price) at which the buyer (distributor) resells the product to a third party. The AML contains a general prohibition of RPM. While Chinese courts look at the prohibition generally in a flexible way (using a ‘rule of reason’ approach), the NDRC seems to treat it as a strict prohibition. Therefore, for companies doing business in China, this means RPM should be generally off-limits. In practice, many companies in China have resale price policies for distributors so the impact of the RPM prohibition has had a great impact.

To an extent, some relief may be coming through: the NDRC's draft guidelines for the automotive sector suggest that agents (which do not take ownership and

risk in the product), and other intermediaries playing a subordinate role, may not fall under the RPM prohibition.

Apart from RPM, there are other restrictions the AML imposes on companies' vertical relationships, but these only apply to companies with a “dominant market position”. For these companies, the AML sets out a number of restrictions but—broadly speaking—they can be classified into two categories. On the one hand, dominant companies cannot behave anti-competitively to exclude competitors from the market. An example of this first category is the imposition of exclusivity on customers. On the other hand, dominant companies are prohibited from engaging in certain conduct which directly harms customers, in particular consumers. Examples of this second category are excessively high prices or discrimination between customers.

### What measures to take?

Companies generally need to take a variety of measures to ensure a high level of competition law compliance. The most obvious measure is to review the company's written contracts and amend the risky clauses, if needed. For example, over the past few years, many companies have had to revise their distribution agreements to eliminate clauses forcing resale prices on their distributors.

However, contract review is clearly not sufficient to ensure full compliance. To a large extent, competition law is ‘effects-based’. This means that it is the effect, not the form, of the conduct that counts. So it is not necessary to have a ‘smoking gun’ clause written into a contract to have a competition law problem.

The resale price example mentioned above clearly shows this: at the beginning of China's modern competition law history, many RPM cases involved resale price restrictions imposed on distributors in writing through formal agreements. However, the RPM cases which the NDRC has brought in more recent months or years often did not involve written clauses, but other types of conduct – for example, oral warnings and threats to distributors by the companies' sales teams. In this case, the legal assessment—including the fines imposed—is basically the same as for RPM clauses in written agreements.

One of the main focuses of competition law compliance is to eliminate or reduce the risks of there being illegal cartel activities by company employees. In most cases cartel activities are—almost by definition—secret (the stereotyped image is that of a smoke-filled room where business people discuss their prices). Generally, there are no or few traces of written communications (although in recent cases, some cartelists were found to have used Wechat, Whatsapp and other electronic means to conduct illegal price discussions).



So what measures can be taken apart from contract review? This depends on the company's needs, culture and risk appetite. A relatively far-reaching measure is to conduct an internal investigation/audit, with an aim to double-check employees' competition law compliance.

Another compliance measure is to conduct interviews with selected employees whom the company deems are potentially more exposed to competition law issues than others, such as employees from the sales team, for example. Many times outside counsel conducts these interviews, as the absence of a hierarchical and day-to-day relationship may allow a more frank discussion.

Furthermore, training and written guidance documents (such as competition law manuals and 'dos and don'ts' lists) are frequently among the competition law compliance measures which companies take. Ideally the training and documents should be tailored for the different groups within the company (for example, an employee from the sales team may face different competition law issues than a factory manager) and should be short and illustrative, so that the takeaways can be easily remembered. Legalese is not a welcome language here.

Beyond compliance with substantive competition rules, companies can also take a variety of other measures to make sure they are prepared in the event that a Chinese competition authority starts an investigation.

For example, companies can prepare for the eventuality of a 'dawn raid' (an unannounced inspection) by the authorities. Past enforcement cases in China have shown that many things can go wrong during competition law dawn raids, ranging from employees shredding documents to managers sipping coffee next door while the office is raided. Hence it is important for companies

to have protocols or guidelines in place for such an eventuality, so that different groups of employees (such as the receptionist, the IT department, top management) know exactly what to do.

Certain companies even take it a step further and organise mock 'dawn raids' at their China business premises. These exercises can genuinely test the employees' reaction to this situation, but they need to be very carefully organised in order to avoid false rumours and other risks.

### Take-aways

Failure to comply with China's competition rules can be costly. But companies have a wide range of measures available to increase compliance levels among their employees.

Beyond individual measures, the level of competition law compliance will also depend on the company culture in general and its legal compliance culture in particular. Obviously, changes of culture can be slow to take root and hence a regular and consistent effort is required to ensure effective competition law compliance across companies' China operations. [Eb](#)

**Hogan Lovells** is a global law firm with over 2,800 lawyers across close to 50 offices around the world, including in Beijing, Shanghai and Hong Kong. Hogan Lovells has one of the largest and most experienced competition law teams on the ground in China. The lawyers in the China competition law team have supported a wide range of companies – including European consumer goods and technology companies, a large Japanese conglomerate and one of China's largest state-owned enterprises – in their competition law compliance efforts, including internal investigations, mock dawn raids, preparation of manuals and guidelines, etc.