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How Safe Is the Safe Harbor Under China's Amended AML?

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Eight months after the release of a draft for public comments in October 2021, China finally promulgated the amended Anti-monopoly Law (AML), which will become effective on August 1, 2022. Whereas the amended AML conceptually retains the safe harbor mechanism for monopolistic agreements that was proposed in the draft amendment in 2021, significant changes exist.

Proposed Safe Harbor Under 2021 Draft Amendment to AML

Under the draft amendment in 2021, if a company's market share falls below certain thresholds to be determined by the state competition authority, a contractual arrangement entered into by such company, regardless of whether horizontal (i.e., with competitors) or vertical (i.e., with suppliers, customers or other non-competitors), would be presumed to fall outside of the scope of monopolistic agreements prohibited by AML, unless such arrangement is proved to have the effect of eliminating or restricting competition.

Safe Harbor Under Amended AML

The safe harbor under the amended AML presents the following difference:

- **Vertical only** – The safe harbor will be applicable to vertical restrictions only, including resale price maintenance. Horizontal restrictions (e.g., price fixing, division of sales markets, restrictions on output or sales volume) will not be eligible for the protection under the safe harbor.
- **Extra condition(s)** – In addition to the market share test, a company must satisfy "other condition(s)" set by the state competition authority in order to enjoy the safe harbor protection.
- **Consequence** – Where a company and its counterparty both satisfy the market share test and other condition(s), instead of being presumed to be non-monopolistic, the vertical arrangements between them will not be prohibited by AML.

Market Share Test

The amended AML delegates the authority to determine the market share test for the safe harbor to the state competition authority, i.e., the State Administration for Market Regulation (SAMR). SAMR has released a draft amendment to the Regulation on Prohibition of Monopolistic Agreements (the Draft Regulation) for public comments. Under the Draft Regulation, the market share test would be satisfied if a company and its counterparties each has a market share of less than 15% in each relevant market, unless otherwise required by the state competition authority.

It appears from the Draft Regulation that all types of vertical restrictions (including resale price maintenance) will be subject to the same market share test, though the Draft Regulation seems to allow SAMR to set a different market share test for certain specific types of vertical restrictions or for certain industries.

Notably, for the purpose of determining the eligibility for the safe harbor, a company's market share must combine the market share of such company and any other entity that it controls or otherwise has a decisive impact on. Where multiple counterparties are involved, their market shares must be combined as well.

Extra Condition

In addition to the market share test, the Draft Regulation requires, as the other condition for the protection under the safe harbor, that no evidence proves that the vertical restriction at issue has the effect of eliminating or restricting competition. The burden of proof would lie with the company that imposed such restriction.

As the amended AML already specifies that any vertical arrangement that has no effect of eliminating or restricting competition will not be prohibited, such extra condition for the safe harbor seems confusing. In particular, if a company were able to prove that an arrangement would not eliminate or restrict competition, it would not need to rely on any safe harbor.

Such extra condition would increase the uncertainty in determining whether the safe harbor applies and may expose a company to the risk of violating the AML if the conclusion of the competition authority in connection with such extra condition differs from that of such company.

Filing With SAMR

The Draft Regulation allows a company to submit a voluntary filing to SAMR (or its local counterparts) proving its eligibility for the safe harbor. Such filing must include information on the business operation and shareholding structure of such company and its counterparties, their respective market shares in the relevant markets and the basis for calculation, and the absence of anti-competition effect in connection with the vertical restrictions at issue. If SAMR verifies that all the conditions for the safe harbor are satisfied, it will not investigate, or it will terminate the investigation, if already initiated.

Such filing, if verified by SAMR, may assure a company that the contemplated vertical restrictions would likely not be prohibited. It is, however, unclear from the Draft Regulation how soon SAMR will complete its verification. Moreover, the market conditions could change during the course of SAMR's verification and thereafter. Consequently, supplemental materials might need to be submitted, and SAMR's conclusion might be effective only under certain circumstances or for a limited period.

How to Make Safe Harbor Safer

The safe harbor is certainly a big leap in the development of the PRC anti-monopoly framework. Given the conditions that must be satisfied to enjoy the protection and the changing market situation, such safe harbor may not always be safe. Where a company intends to impose a vertical restriction on its business partners in reliance upon the safe harbor protection, it should consider the following:

- The correct relevant product markets and geographic markets need to be identified, which would dictate the market shares of the companies in such markets.
- Where possible, it would be prudent to conduct a due diligence investigation with respect to business partners' performance in the relevant markets, including, in particular, their market shares.
- Business partners' representations with respect to their market shares and other matters that may affect the eligibility for the safe harbor may be useful. It may also be desirable to obtain business partners' covenants to notify the company of any material changes in those respects.
- Any vertical restriction that presents competition concerns should be subject to periodic review. Specific market data should be collected to allow a quantitative assessment of the impact of such restriction on competition.

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