

Unreliable Entity List Embraces Abuse of Dominance under the AML of the PRC

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On May 31, 2019, the Ministry of Commerce of China (“MOFCOM”) announced that China will establish an “Unreliable Entity List” (“UEL”) targeting on foreign entities and individuals that fail to comply with the principles of market economy, deviate from the contractual spirit, or cut off supplies to Chinese companies for non-commercial purposes, as well as that threaten the China national security or seriously damage the legitimate rights and interests of Chinese companies. Later on, on June 1, 2019, Mr. Wang Hejun, the Director General of the Treaty & Law Department of MOFCOM, further disclosed some key messages explaining the UEL and stated that more specific restrictions and measures will be promulgated in due course.

According to MOFCOM’s spokesman, the UEL will base its legal grounds on the Anti-Monopoly Law (“AML”), the Foreign Trade Law and the National Security Law of China, and other relevant regulations. This deep root of the AML in the UEL is later reemphasized by Mr. Wang Hejun during the joint press interview on June 1, 2019, during which the concept of abuse of market dominance in the AML seem to be heavily relied on. As some believed the UEL regime aims to respond to the executive order signed by the U.S. President Trump on May 16 to prohibit U.S. companies from continuing to supply to or cooperate with Huawei and its affiliates, it is anticipated that the future impact by the UEL will not be negligible, and the importance of the AML will continue to rise. Therefore, this article provides the currently known framework and possible implementation of the UEL with a focus on the AML, particularly including four sections: (i) general rules of the UEL, (ii) link between the UEL and the AML, (iii) conducts potentially targeted by the UEL and the AML, and (iv) conclusion.

I. General Rules of the UEL

The Chinese government has announced that the specific procedures and rules of the UEL are around the corner, and the first batch of the foreign entities under the UEL will be issued soon. While the details of the UEL remains a mystery for now, however, the MOFCOM spokesman indicated that there are four criteria to determine whether a foreign entity shall be added into the UEL:

- Whether the entity implements blockade, cut-off of supply or other discriminatory measures against Chinese entities;
- Whether the action of the entity fails to comply with the principles of market, deviates from the contractual spirit, or constitutes boycott or cut off supplies to Chinese companies for non-commercial purposes;

- Whether the action of the entity causes material harms to Chinese enterprises or the related industries; and
- Whether the action of the entity threatens China’s national security.

The legal grounds that China could base to take any necessary legal and administrative measures against the UEL entities include the Foreign Trade Law, the AML and the National Security Law. Corresponding to the statements of the Chinese high-rank officials, the jurisprudence of abuse of market dominance under the AML is widely anticipated to be one of the rocks on which China will build and enforce the UEL, as further elaborated below.

II. The UEL embraces the AML

During the joint press interview, Mr. Wang Hejun specifically pointed out that Article 17 of the AML prohibits the entities which possesses a dominant position in the relevant market from abusing its market dominance, and emphasized that it would be a violation of the AML in any country around the world if such entities restrict or cut off the trade cooperation with other companies due to non-commercial reasons. Although MOFCOM did not specify which types of behavior under the abuse of market dominance, one could reasonably forecast that “refusal to deal” and “imposing unreasonable trading conditions” may be the front line for the UEL, while other types of behaviors are also not to be ignored based on the enforcement record of the Chinese authority.

Looking through Article 17 of the AML, there is a non-exhaustive list of six types of behaviors that are typically regarded as abuse of market dominance, including (i) selling commodities at unfairly high price or purchase commodities at unfairly low price; (ii) selling commodities at below-cost price without any justifiable causes; (iii) refusal to deal with a trading party without any justifiable causes; (iv) restricting their trading party so that it may conduct deals exclusively with themselves or with the designated business operators without any justifiable causes; (v) implementing tie-in sales or imposing other unreasonable trading conditions at the time of trading without any justifiable causes; and (vi) applying discriminatory treatments on trading prices or other trading conditions to their trading parties with equal standing without any justifiable causes.

Therefore, based on the current information released by Chinese government, the premise for whether a foreign entity shall be added to the UEL probably has close relation with examining the legal elements of abuse of market dominance under the AML. Thus, we would like to “disassemble” the conducts which might be targeted by the UEL based the AML – an arsenal of the Chinese government now.

III. Potential Conducts Targeted by the UEL and the AML

According to the AML and the relevant supplementary regulations, there are four steps to be taken when deciding whether an undertaking abuses its dominant position in the relevant market:

- (i) Whether an undertaking possesses a *market dominant position* in the relevant market;
- (ii) Whether an undertaking commits any *abusive conduct*;
- (iii) Whether there is any *justifiable reason for such conduct*; and
- (iv) Whether the abusive conduct has *the effect of eliminating and restricting competition* in the relevant market.

1. Market Dominant Position in the Relevant Market

The initial element of constituting an abuse of market dominance is that the entity should possess the market dominant position in the relevant market. Article 19(1) of the AML provides the market share could be an index for the assessment.

Where the market share of an undertaking is less than the prescribed amount, it should take other comprehensive factors into consideration when determining the dominant position, for example, competitive landscape in the relevant market, ability that the undertaking could control sales market or raw material procurement market, the financial and technical conditions of the undertaking, dependence of other market players on trade with the undertaking, market entry barriers, and other related factors.

2. Abusive Conduct

➤ Refusal to deal

Generally, an undertaking with market dominance is forbidden to delay or cut off the existing transactions or refuse to enter into new transactions with a trading party, or set restrictive conditions to make it difficult for the trading party to trade with the company, without justifiable reasons.

Assuming an U.S. company ceases to supply to or cooperate with or refuse to negotiate new transactions with a Chinese company, it might be regarded as “refusal to deal” under Article 17 of the AML by Chinese antitrust authority.

➤ Imposing unreasonable trading conditions

Another antitrust risks for a foreign company to cut off the trade would be “imposing unreasonable trading conditions” under Article 17 of the AML if the entity requests their distributors not to supply products to specific Chinese company or cease the cooperation. In China, a company with market dominance is not allowed to impose unreasonable trade conditions, including unreasonable restrictions on sales areas, sales customers and after-sales services, and additional transaction conditions unrelated to the subject matter of the transaction without justifications. Even though the distributor voluntarily commits to cut off the supply, in practice it is might be

interpreted as a result of market dominance of the foreign entity.

3. Justifiable Reasons

According to the AML and relevant supplementary regulations, the "justifiable reasons" that China's antitrust/competition authority will consider in the case of abuses of market dominance would be as follows: (i) whether the relevant acts must be taken for the purpose of regular business activities and benefits; (ii) whether the relevant acts can benefit the trading parties or consumers; (iii) whether the relevant acts positively influence on business development, future investment and innovation of the undertaking; (iv) whether the relevant acts positively influence on operation efficiency, social and public interests and economic development; and (v) whether relevant acts might exclude or severely restrict existing or potential competition in the relevant market.

According to the above-mentioned provisions, the U.S. companies could, for example, defend itself that they must abide by their national laws and regulations to cease the supply and also on the basis of their regular business activities. However, the chance of success of this defense remains unclear in China for now. In fact, there exists varying opinions on this international comity issue across different jurisdictions in addition to China. For instance, on one hand, *Comitas Gentium* principle of international law raised by Ulrik Huber requires mutual recognition of legislative, executive, and judicial acts among different political entities. On the other hand, in *Animal Science Products, Inc. v. Hebei Welcome Pharmaceutical Co., Ltd.*, the Eastern District of New York considered that the Chinese law relied upon by defendants did not compel their illegal conduct, while later Judge Hall upheld that the Chinese government deserved the same respect and treatment that the U.S. would expect to receive in comparable matters before a foreign court.

Notably, the antitrust authority has discretion in determining whether to accept the proposed justifiable reasons.

4. Weighing of Competitive Effects - Rule of Reason

Rule of Reason is applied to assess abuse of market dominance in China, meaning the weighing of anti-competitive effects against the economic efficiencies. The analysis of competitive effects relies on various factors according to the laws and regulations of China, such as competition landscape in the relevant market, numbers and differentiation of competitors, concentration degree of the relevant market, undertaking's ability to control the market, entry barriers for other potential player, whether to bring in economic efficiency, dependence of other market player on the undertaking, the foreclosure effect arisen by the abusive conduct, etc.

On April 29, 2019, local branch of the State Administration for Market Regulator ("SAMR") imposed administrative penalty on Eastman against its abuse of market dominance. It could be seen from the decision that SAMR determined to impose

penalty through analyzing the damages on the relevant market caused by the abuse of market dominance, and emphasized the anti-competitive effect overwhelmed the economic efficiency in the case.

In summary, based on the objective and legislative purpose of laws and regulations and based on the precedents, it is necessary to analyze whether the abusive conduct has the effect of eliminating and restricting competition in the relevant market, and to further evaluate the balance of anti-competitive effects and pro-competitive effects. Indeed, although this is a statutory obligation SAMR shoulders, the reality may not be that straight forward. Except for the competition concerns, some other factors may also influence the review on any potential investigation, such as national security, including economic security, science and technology security, information security and resource security; public interests and the legitimate interests of enterprises and prevent Chinese entities from major risks like cut-off of supply or blockade, and fair and equitable international economic orders and the rules-based multilateral trading rules and protect the security and stability of the global industrial chain. These considerations are relatively broad and “construable”, potentially leaving any justifiable reasons a raindrop into the ocean during the balance test.

IV. Conclusion

On its appearance, some seem that China announced the UEL in response to U.S. BIS Entity List. While specific provisions have not been established, the conducts and related foreign companies would be increasingly concerned, especially when the end of the trade friction seems still far away. The enforcement and implementation of the UEL as well as its legal liabilities are expected to be somewhat comparable to the measures on Huawei and its affiliates by the U.S government. Based on the available information, nevertheless, it is anticipated that the UEL will be associated with the AML in a profound fashion, especially for those foreign entities with noticeable market presence in China. While no SAMR officials have made public statement on this, the competition authority seems to have little reason not to stand by MOFCOM’s side, and the AML should be involved and promoted together with other emerging regulations and administrative governs along with the UEL.