Kluwer Competition Law Blog

“Single entity defense” under scrutiny in China

Adrian Emch (Hogan Lovells, China) · Thursday, July 26th, 2018

On 20 July 2018, the new Chinese antitrust authority – the State Administration for Market Regulation (**SAMR**) – published two decisions sanctioning two ship tallying companies in Shenzhen for market partitioning and price fixing (see the *Shenzhen Tally* decisions here).

Although the case is local and the decisions are short, the decisions have the potential to significantly impact business practices and structures in China. In particular, these decisions' most significant point is SAMR's rejection to apply the "single entity defense" to 50:50% joint ventures. If the *Shenzhen Tally* decisions reflect the general thinking at SAMR, many companies with 50:50% joint ventures would need to re-assess whether antitrust rules apply between their affiliates. Given that foreign companies quite frequently resort to joint venture structures – be it due to regulatory requirements or to easier market access through local partner – the decisions may have an important impact on multinational companies doing business in China.

Background

According to SAMR's decisions, two tallying service providers in the port of Shenzhen – China Ocean Shipping Tally Shenzhen and China United Tally (Shenzhen) – had engaged in anti-competitive practices from May 2013 to August 2016.

Tallying service providers count the number of cargo pieces loaded onto or unloaded from a ship to prevent disputes between the shipper and the carrier. For a long time, there was only one state-owned tallying service provider in China – China Ocean Shipping Tally Company. In 2002, the Chinese government introduced the second tallying service provider – China United Tally Company Limited. The two companies involved in the *Shenzhen Tally* case are affiliates of these two companies. In 2015, the government further relaxed regulation and started to allow more players to enter the tallying service market.

In the current case, the collusive practices included a market partitioning agreement whereby each of the two operators would have the right to a 50% market share. When one of the operators reached its 50% market share, it would hike the prices for additional customers so much as to drive them to the other operator. The two companies also had a mechanism of settling revenues received in excess of the 50% market share between them. The two companies stopped the collusive practices after a third tallying service provider entered the Shenzhen port in August 2016.

In addition, the two companies collectively raised the prices of tallying services.

In November 2017, the antitrust unit at the National Development and Reform Commission (**NDRC**) – one of predecessors of SAMR's antitrust body/ies – started an investigation into the companies' practices. After receiving the sheet of charges from SAMR, the companies presented their defenses in May 2018. SAMR adopted its final decisions on 9 July 2018 and published the decisions 11 days later.

"Single entity defense"

One of the companies' main line of defense arguments was that the cartel provision in the Anti-Monopoly Law (**AML**) did not apply, as the companies were part of the same group (called "single entity defense" in other jurisdictions).

China Merchants Logistics held 50% shares in both companies. Regarding the remaining shareholders, there were differences between the two companies: China United Tally (Shenzhen) only had one other shareholder owning the remaining 50% of shares, while China Ocean Shipping Tally Shenzhen had two other shareholders with 29% and 21% of shares.

However, SAMR dismissed the "single entity defense" argument, putting forward three reasons:

- While China Merchants Logistics held a 50% shareholding in each of the companies, it only held a "relative controlling position" in one of them (where the other two shareholders had 29% and 21%), not in the other (where the other shareholder held 50%).
- From the operative perspective, the two companies were run independently of each other, at least after the entry of the third tallying service provider.
- Regulations issued in 2002 that formed the second tallying company were aimed at creating competition and limiting joint ownership in the tallying services area.

The new decisions suggest the single entity defense is not available to 50:50% joint ventures in the particular circumstances of this case. This is an important development, since there have been no provisions in the AML or its implementing rules which regulate the single entity defense (outside the merger control context).

The development does not come as a total surprise, since there had been some investigations by NDRC targeting affiliated companies. However, the two decisions in the *Shenzhen Tally* case represent the first detailed discussion by a Chinese antitrust authority on whether and how the single entity defense theory applies.

That said, the rejection of the single entity defense is arguably fact-specific to this case. For instance, the sectoral regulation at issue was aimed at opening up the tallying service market and introducing competition into the market, hence an anti-competitive agreement between the then only two players in Shenzhen port seems to run counter to that proposition.

In addition, an important reason for rejecting the single entity defense appears to have been that the two companies were run independently and might have created the impression of being in competition. This is consistent with a prior NDRC case targeting affiliated companies. In a way, the idea here is that where companies give the appearance of competing, they need to be actually

doing so. Where 50:50% joint ventures use the brand of only one of the parent companies, there may arguably be no such appearance.

Government guidance

Another argument in the parties' defense was that the prices for tallying services were government-guided. SAMR dismissed this argument on the ground that any government guidance or intervention on pricing would still not allow for concertation between the companies. To the contrary, SAMR found that the companies needed to determine their market conduct independently.

The reasoning here resembles EU caselaw, such as in the Deutsche Telekom case where the EU courts essentially ruled that companies are subject to antitrust law for those areas where they enjoy decision-making powers in an otherwise regulated area.

This finding may provide important guidance for future cases, as several sectors in China's economy are still relatively heavily regulated. The message here is that companies cannot hide behind sectoral regulation, but need to assume their own antitrust responsibilities.

Takeaways

The *Shenzhen Tally* decisions are the outcome of a string of antitrust enforcement measures in the shipping sector. The driver behind those cases may well have been, at least at the beginning, the perceived need to lower export costs. More generally, the decisions show that SAMR, like its predecessor bodies, focuses on certain sectors to prioritize antitrust enforcement. Life sciences companies, for example, will have duly taken note.

Most importantly, the *Shenzhen Tally* decisions provide long-awaited guidance on the single entity defense in China, but perhaps not to the taste of many companies. Many market players including multinationals will need to re-assess what risks their governance structures including 50:50% joint ventures face under the Chinese antitrust rules following these decisions.

To make sure you do not miss out on regular updates from the Kluwer Competition Law Blog, please subscribe here.

To make sure you do not miss out on regular updates from the Kluwer Competition Law Blog, please subscribe here.

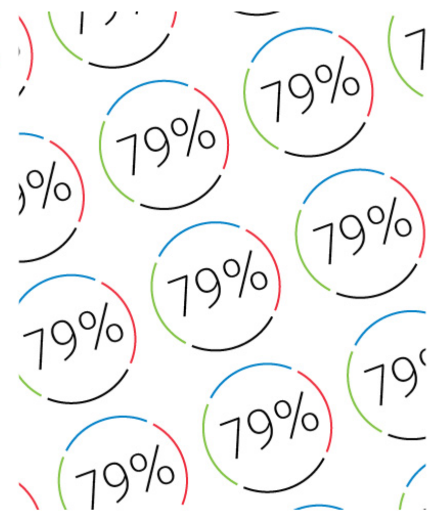
Kluwer Competition Law

The **2022 Future Ready Lawyer survey** showed that 79% of lawyers are coping with increased volume & complexity of information. Kluwer Competition Law enables you to make more informed decisions, more quickly from every preferred location. Are you, as a competition lawyer, ready for the future?

Learn how **Kluwer Competition Law** can support you.

79% of the lawyers experience significant impact on their work as they are coping with increased volume & complexity of information.

Discover how Kluwer Competition Law can help you.
Speed, Accuracy & Superior advice all in one.



2022 SURVEY REPORT
The Wolters Kluwer Future Ready Lawyer
Leading change

This entry was posted on Thursday, July 26th, 2018 at 3:00 pm and is filed under China, Price fixing
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.