

China Antitrust Review 2015

January 19, 2016

The past year (2015) saw the seventh year of China's Anti-Monopoly Law ("AML"). This note identifies several significant trends in Chinese antitrust enforcement and illustrated the degree to which it deviates from Western antitrust norms. The Chinese authorities appear to have moved away from the "hold separate" remedies that they have imposed in recent years, thereby mitigating one significant divergence with Western authorities. On the other hand, much of Chinese antitrust enforcement in 2015 still stands in contrast to Western approaches. Indeed, several of China's enforcement priorities in 2015 appear to suggest ongoing concerns about the economic strength of the domestic economy in ways that are at odds with Western antitrust norms. In 2015, this trend has been particularly evident in industries involving intellectual property and patent-licensing practices. For example, China imposed a record-high fine against one Western company (Qualcomm) for charging excessive royalties to Chinese licensees, despite significant advance criticism from international antitrust authorities that China should not do so.

Below, we review significant developments and identify trends of note to companies subject to AML enforcement.

I. Merger Control

A. Merger Control Decisions

In 2015, MOFCOM's level of merger enforcement activity declined, with MOFCOM blocking no deals and imposing remedies in only two transactions, a number notably lower than the number of cases in which MOFCOM has imposed remedies in recent years. (In 2014, conditions were imposed in five transactions; in 2013, four; and in 2012, six.)

The decline in the number of merger remedies imposed is all the more notable in that the total number of transactions reviewed by MOFCOM *increased significantly* during 2015. In 2015, MOFCOM received 352 notifications (up 34.4% from the same period in 2014) and closed 319 cases (up 30.2% from 2014).¹ The precise reason for the significant increase in the pace of MOFCOM's review is not entirely clear. In the past, some observers have suggested that MOFCOM move more slowly than its Western counterparts due both to its small size (approximately 30 staff members, including administrators) and its coordination with other Chinese agencies.² It appears from recent reports that the increase in volume of transactions MOFCOM reviewed is due primarily to two initiatives: (1) MOFCOM's internal efforts to eliminate pre-review consultations, and (2) its 2014 implementation of "simple" merger review procedures designed to speed antitrust review for merger cases that do not raise substantive concerns (e.g., if the parties' combined market shares fall below 15% in the same market or 25% in vertically related markets).

The *substance* of MOFCOM's enforcement activity in 2015 is also notable for at least some activity that reflects Western antitrust norms, and some that diverges sharply from them. In 2014, MOFCOM blocked

¹ See Ministry of Commerce, 2015 Year-End Review No. 9 – Active Implementation of Antitrust Enforcement and Protection of Fair Market Competition (January 15, 2016), available at <http://www.mofcom.gov.cn/article/ae/ai/201601/20160101235053.shtml> (Chinese language).

² Fei Deng and Cunzhen Huang, *A Five Year Review of Merger Enforcement in China*, THE ANTITRUST SOURCE (Oct. 2013), at 6. See, e.g., D. Daniel Sokol, *Merger Control Under China's Anti-Monopoly Law*, 10 N.Y.U. J. L. & BUS. 1, 13–14 (2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2207690.

a merger outright that had been cleared by U.S. and EU authorities—the “P3” operational joint venture between shipping companies A.P. Moller-Maersk, Mediterranean Shipping Company, and CMA CGM.³ Similarly, between 2011 and 2013, in *Seagate/Samsung* (2011), *Western Digital/Hitachi* (2012), *Marubeni/Gavilon* (2013), and *MediaTek/MStar* (2013), MOFCOM diverged from Western authorities in requiring merging parties to “hold separate” their respective businesses rather than integrating them post-merger (effectively reducing the synergy value of strategic combinations). In 2015, however, MOFCOM diverged less frequently from Western counterparts, differing in one deal, *Nokia/Alcatel* (which was cleared without conditions in the U.S. and the EU) and aligning in another, *NXP/Freescale*.

Nokia/Alcatel. In October 2015, MOFCOM conditionally cleared the \$17.6B acquisition of Alcatel-Lucent (“Alcatel-Lucent”) by Nokia Corporation (“Nokia”), approximately seven months after the parties initially notified the transaction. Prior to MOFCOM’s imposition of a remedy, the U.S., the EU, and various other authorities cleared *Nokia/Alcatel* without conditions.

The acquisition combined two companies in the telecommunications equipment space, particularly around wireless networks. MOFCOM determined that the transaction would be unlikely to restrict competition in a variety of markets, including China’s 2G, 3G, and 4G radio access networks, its core network systems, and its network infrastructure services. MOFCOM did, however, raise concerns regarding the combined entity’s strength in standard-essential patents (“SEPs”), particularly those in wireless networks. MOFCOM found that the transaction would increase Nokia’s share of 2G, 3G and 4G SEPs and strengthen its concentration in the SEP licensing (from 25-35% to 35-45% in 2G and 3G SEP licensing and placing it ahead of Qualcomm to become the market leader in 4G SEP licensing). MOFCOM viewed SEP licensing as the primary barrier to entry in smartphone manufacturing. MOFCOM found that pre-merger, Chinese wireless equipment and handset makers do not have sufficiently strong portfolios and negotiating power to cross-license with Nokia, and, post-merger, Nokia could withhold or restrict access to its SEPs in a way that could force Chinese manufacturers to exit the market or pass on price increases to end-consumers.

MOFCOM approved the transaction subject to three remedies covering each of the parties’ 2G, 3G, and 4G SEPs: (i) a commitment to license SEPs on a fair, reasonable and non-discriminatory (“FRAND”) basis and not to enforce SEPs with injunctions unless licensees were unwilling to accept FRAND license terms; (ii) a commitment to inform Chinese licensees and Chinese companies engaged in licensing negotiations about transfers of SEPs to third parties; and (iii) a commitment not to transfer SEPs to third parties except on the condition that the third party accepts Nokia’s FRAND commitments.

By contrast, in *Google/Motorola Mobility* (2012), the U.S. Department of Justice declined to anticipate future FRAND violations as a remedy in a merger context, instead stating that the future exercise of SEPs “remains a significant concern” and will be the subject of ongoing agency monitoring.⁴ Subsequently, in 2013, the Federal Trade Commission provided for arbitration provisions when licensing negotiations over SEPs break down. Instead of leaving such negotiations to private parties in the first instance, in *Nokia/Alcatel*, MOFCOM provided a more direct route to ensure that Chinese wireless equipment and handset makers would receive licenses from the merging parties on FRAND terms.

NXP/Freescale. In November 2015, MOFCOM approved the approximately \$12B acquisition of Freescale Semiconductor, Ltd. (“Freescale”) by NXP Semiconductors N.V. (“NXP”), imposing structural

³ See Davis Polk & Wardwell LLP, *China Antitrust Review 2014* (Jan. 28, 2015), available at http://www.davispolk.com/sites/default/files/2015_01_27_China_Antitrust_Review_2014.pdf.

⁴ U.S. Department of Justice, Press Release (Feb. 13, 2012) available at <http://www.justice.gov/opa/pr/statement-department-justice-s-antitrust-division-its-decision-close-its-investigations>.

remedies similar to those conditions ordered by the U.S. and the EU.⁵ MOFCOM issued the conditional approval almost eight months after the case was first notified.

NXP and Freescale develop and manufacture semiconductor products for systems including radio frequency (“RF”) power transistors, in which MOFCOM found that the parties would have a combined market share of 54% in the global market for RF power transistors and 84% in the market for the mainstream technologies used for RF power transistors. MOFCOM concluded that the transaction, by eliminating competition between the two largest and closest competitors in the space, would reduce customer options and increase the risk of price increases, adversely affect research and development, and further increase entry barriers in a space that turns on competitors’ access to patents and reputational standing with customers.

Antitrust authorities, including at least the Federal Trade Commission in the U.S. and MOFCOM, required NXP to divest its entire RF power transistor business to Jianguang Asset Management Co. Ltd (“JAC Capital”), a divestiture which was voluntarily proposed by NXP.⁶

B. Release of Previously Imposed Hold Separates

Western Digital/Hitachi GST and Seagate/Samsung HDD. In October 2015, MOFCOM released restrictive “hold separate” conditions it had imposed in two hard disk drive acquisitions: *Seagate/Samsung* (2011) and *Western Digital/Hitachi* (2012), both of which had been under extended review for release. As noted above, those constraints required the target entities (Samsung and Hitachi) to remain as independent competitors and not to integrate with the buyer.⁷ In October 2015, MOFCOM permitted the parties to those deals to integrate, with the proviso that, due to continuing concerns about Western Digital’s and Hitachi’s combined market shares reducing customer bargaining power, it maintained its prohibition on integration of Western Digital’s and Hitachi’s *sales teams* and *product brands* for two more years, at which point the conditions will cease automatically (unless the parties apply for and are granted earlier release).

C. Penalties for Violations of Reporting Requirements

Since February 2012, MOFCOM’s regulations have provided for penalties for noncompliance with the AML’s reporting obligations, including an ability to impose fines of up to RMB 500,000 (approximately \$75,000 USD) and/or an order to unwind the unreported transaction. In March 2014, MOFCOM announced that it would publish penalty decisions for failure to notify transactions, the first of which was announced in December 2014 against Unigroup.

In September 2015, MOFCOM announced penalties for failure to notify in four additional transactions. Those penalties were levied against both foreign and domestic companies: (i) Microsoft and BesTV New Media were each fined RMB 200,000 for their failure to notify the incorporation of a joint venture; (ii) Shanghai Fosun Pharmaceutical was fined RMB 200,000 for its failure to notify an acquisition of 35% equity interest in Suzhou Erye Pharmaceutical; (iii) Fujian Electronics & Information (Group) Limited was

⁵ See Fed. Trade Comm’n, Press Release (Nov. 25, 2015), available at <https://www.ftc.gov/news-events/press-releases/2015/11/ftc-requires-nxp-semiconductors-nv-divest-rf-power-amplifier>; European Comm’n, Press Release (Sept. 17, 2015), available at http://europa.eu/rapid/press-release_IP-15-5674_en.htm.

⁶ NXP entered into the agreement to sell its RF power transistor business to JAC Capital in May 2015. See NXP’s Press Release, NXP Semiconductors Announces Agreement to Sell RF Power Business, available at <http://media.nxp.com/phoenix.zhtml?c=254228&p=irol-newsArticle&ID=2118055>.

⁷ See Davis Polk Client Alert, *MOFCOM Lifts Many, But Not All Hold Separate Requirements Previously Imposed as Conditions to Clearance of Hard Disk Drive Deals* (Oct. 23, 2015) available at http://www.davispolk.com/sites/default/files/MOFCOM_Lifts_Many_But_Not_All_Hold_Separate_Requirements_Previously_Imposed.pdf.

fined RMB 150,000 for its failure to notify an acquisition of a 35% equity interest in Shenzhen Zhongnuo Communications; and (iv) Bombardier Transportation Sweden and CSR Nanjing Puzhen were each fined RMB 150,000 for their failure to notify the incorporation of a joint venture.

The relatively low level of the fines that MOFCOM is authorized to impose has been criticized by practitioners as potentially insufficient to be an effective deterrent. Though MOFCOM has the power to unwind a transaction, so far it has not yet exercised this power.

II. NDRC Enforcement Actions

In 2015, NDRC concluded its landmark investigation into SEP licensing practices by Qualcomm Inc. (“Qualcomm”), imposing record fines, and also issued heavy fines against two automobile manufacturers, Mercedes-Benz and Dongfeng-Nissan.

Qualcomm Investigation into Abuse of Dominance. On February 10, 2015, NDRC announced that it had concluded its investigation by ordering Qualcomm to cease certain abuses of market dominance and to pay a fine of RMB 6.088B (approximately \$930M USD). In March 2015, NDRC elaborated upon its findings, stating that it had found Qualcomm to have violated the AML in several markets in which it has a dominant position (the SEP licensing market for CDMA, WCDMA, and LTE baseband chips, in which NDRC found Qualcomm to have a 100% share, and the baseband chip markets themselves, in which it found Qualcomm to have 93%, 54%, and 96% shares, respectively). NDRC’s decision highlighted three areas of allegedly anticompetitive conduct:

- **Charging unfairly high patent royalties.** NDRC found that Qualcomm had artificially inflated royalties charged to wireless SEP licensees in two ways: one, by charging royalties on expired patents, and two, by demanding free cross-licenses for patents from SEP licensees. Qualcomm had failed to disclose to its licensees the patents for which it had charged its licensees royalties, NDRC concluded, thus depriving licensees of the opportunity to negotiate for access on fair terms. In addition, NDRC found that Qualcomm’s practices of bundling SEPs and non-SEPs and charging licensees at rates based on the net selling prices of handset devices was unfair and led to excessive royalties.

NDRC’s finding is particularly striking given the public criticism of potential liability for excessive royalties raised by Western officials before NDRC had concluded its inquiry. For example, Federal Trade Commission Chairwoman Edith Ramirez criticized NDRC for taking such an approach. “I am seriously concerned by these reports [indicating that China’s antitrust authorities may be willing to impose liability based solely on the royalty terms that a patent owner demands],” she stated, because they “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.”⁸ The Assistant Attorney General for Antitrust at the U.S. Department of Justice, William Baer, also announced that he shared the Chairwoman’s concerns and added: “Using antitrust enforcement to reduce the price firms pay to license technology owned and developed by others is short-sighted. Any short-term gains derived from imposing what are effectively price controls will diminish incentives of existing and potential licensors to compete and innovate over the long-term, depriving jurisdictions of the benefits of an innovation based-economy.”⁹ Jack Lew, the Secretary of the U.S. Department of the Treasury, is reported to have

⁸ Michael Martina and Xiaoyi Shao, *China’s antitrust regulators defend probes; Qualcomm inquiry nearly over*, REUTERS (Sept. 11, 2014), available at <http://www.reuters.com/article/us-china-antitrust-idUSKBN0H60J920140911>.

⁹ Bill Baer, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *International Antitrust Enforcement: Progress Made; Work to Be Done* (Sept. 12, 2014), available at <http://www.justice.gov/atr/file/517736/download>.

sent a letter to his Chinese counterpart that, The Wall Street Journal reported, warned China that its investigations into non-Chinese companies could “devalue foreign intellectual property” and “have serious implications for relations” between the U.S. and China.¹⁰

- **Tying sales of non-SEP licenses without justifiable cause.** NDRC also found that Qualcomm tied licenses of non-SEPs to licenses of SEPs, conditioning licenses of SEPs on non-essential non-SEPs. NDRC found that this conduct harmed licensees, which were limited in their ability to choose from alternative non-SEPs or “design around” Qualcomm’s non-SEPs.
- **Imposing unreasonable terms on the sale of baseband chips.** According to the NDRC, Qualcomm had conditioned certain sales of baseband chips upon “non-challenge provisions” whereby its purchasers had to agree not to challenge the validity of Qualcomm’s patents as a condition to receiving the baseband chips.

In addition to the RMB 6B fine (amounting to 8% of Qualcomm’s 2013 sales in China), NDRC ordered Qualcomm to curtail the sales practices by, (i) with regard to Chinese manufacturers, (a) providing licensees with a patent list and ceasing fees for expired patents, (b) ceasing to obtain free cross-licensing for licensees’ patents, (c) ceasing licenses that tie SEPs to non-SEPs, without justifiable cause, and (d) ceasing unreasonable terms on the sale of baseband chips; and (ii) with regard to products sold for use in China, ceasing to base wireless SEP royalties on the net selling prices of handset devices.

Qualcomm accepted NDRC’s decision and also adopted a “rectification plan,”¹¹ which included commitments to conform company policies to the constraints provided by NDRC.

China’s investigation into certain of Qualcomm’s licensing practices reflects other investigations by global authorities—although international authorities have *not* undertaken a review of excessive royalties charged by Qualcomm (and in fact, as noted, they have voiced their opposition to such a review). Investigations into Qualcomm’s licensing practices generally have been undertaken in Japan, Korea, and the U.S. Another investigation opened by the European Union in mid-2015 includes scrutiny of tying in the baseband chip market.

Automobile Investigation into Resale Price Maintenance. In 2015, two regional regulators under the administration of NDRC levied fines against Mercedes-Benz and Dongfeng-Nissan (Nissan’s China joint venture with Dongfeng Motor), as well as their respective dealers, for resale price maintenance in violation of the AML. Specifically, the regulators concluded that the manufacturers and their dealers had reached and implemented certain agreements to fix minimum resale prices, thereby excluding and restricting market competition. Mercedes-Benz and Dongfeng-Nissan were therefore fined RMB 350M (\$53M USD) and RMB 123.M (\$19M USD), respectively. The dealers were also subject to fines varying from 1% to 4% of their turnover for the previous year.

III. SAIC Intellectual Property Rules and Investigation of Microsoft

Intellectual Property Rules. In August 2015, SAIC’s long-awaited *Regulations on the Prohibition of Conduct Eliminating or Restricting Competition by Abusing Intellectual Property Rights* (“IP Rules”) took effect. The IP rules specifically prohibit a range of anticompetitive behaviors, including, *inter alia*:

¹⁰ Laurie Burkitt and Bob Davis, *U.S. Treasury Warns China Over Antimonopoly Efforts*, THE WALL STREET JOURNAL (Sept. 14, 2014), available at <http://www.wsj.com/articles/u-s-treasury-warns-china-over-antimonopoly-efforts-1410687635?cb=logged0.5509367445483804>.

¹¹ See Qualcomm’s Press Release (Feb. 9, 2015), Qualcomm and China’s National Development and Reform Commission Reach Resolution, available at <http://investor.qualcomm.com/secfiling.cfm?filingid=1234452-15-31&cik>.

- (i) entering into “monopolistic agreements” that use intellectual property rights (“IPRs”) to leverage a dominant market position, with the exception of certain “safe harbors” based on market share and competitive alternatives;
- (ii) imposing restrictive licensing practices, such as refusing to license IPRs to other parties on reasonable terms without justification when such IPRs constitute “essential facilities” for business operations, requiring exclusive dealing with certain parties, tying sales, and discriminating against counterparties to reduce competition; and
- (iii) abusing standards-setting processes to eliminate or restrict competition.

SAIC’s IP rules explicitly do not cover price-related conduct, such as charging excessive licensing fees, as such conduct falls under the jurisdiction of NDRC.¹²

Consistent with the AML and the rules issued by NDRC, SAIC has broad discretion to impose penalties, including the levying of monetary fines from 1% to 10% of violators’ annual sales in the previous year, confiscating the proceeds of anticompetitive conduct, and issuing orders to cease anticompetitive acts.

As discussed in our [China Antitrust Review 2014](#), Western antitrust practitioners, including Federal Trade Commissioner Maureen Ohlhausen, have raised concerns over China’s controversial application of the “essential facilities” doctrine—a contested doctrine which mandates that competitors must have reasonable access to a monopolist’s product or service when that product or service is essential to competition. Nonetheless, the IP Rules in final form require monopolist patent owners to license IPRs to other parties on reasonable terms when such IPRs constitute essential facilities for business operations. There are several factors that SAIC considers in applying the doctrine:

- (i) whether there is no reasonable substitute for the IPR in question, and whether it is essential for other companies to compete in the relevant market;
- (ii) whether the refusal to license will adversely affect market competition or innovation, thereby impairing consumers’ welfare or the public interest; and
- (iii) whether the license of the IPR will cause unreasonable harm to the holder.

Microsoft. News reports have recently addressed an ongoing probe by SAIC into Microsoft’s sales and marketing practices. SAIC recently announced that Microsoft had disclosed data in response to SAIC’s probe that presented “major problems” (which SAIC did not explain). The news reports identify a range of potential concerns, with some suggesting that SAIC is investigating Microsoft’s distribution practices for its Internet Explorer browser and Windows Media Player¹³ and another suggesting that it may be related to Microsoft’s recent decision to discontinue support for its legacy Windows operating system, Windows XP, which is used by many Chinese government offices and private companies.¹⁴

¹² China divides competition enforcement across three separate government ministries: (i) the Ministry of Commerce (“MOFCOM”) is responsible for merger review; (ii) the National Development and Reform Commission (“NDRC”) is responsible for *price-related* conduct; and (iii) the State Administration for Industry and Commerce (“SAIC”) is responsible for *non-price-related* conduct.

¹³ *China Asks Microsoft to Explain ‘Major Problems’ in Probe Data*, DOW JONES BUSINESS NEWS, (Jan. 5, 2016), available at <http://www.nasdaq.com/article/china-asks-microsoft-to-explain-major-problems-in-probe-data-20160105-00380>.

¹⁴ Paul Mozur and Nick Wingfield, *Microsoft Faces New Scrutiny in China*, THE NEW YORK TIMES (Jan. 5, 2016), available at <http://www.nytimes.com/2016/01/06/business/international/microsoft-china-antitrust-inquiry.html>.

IV. Conclusion

In 2014, China diverged significantly from Western antitrust enforcement norms in several key enforcement decisions. This divergence appeared to decline in 2015 with some enforcement activity in China that is more aligned with Western enforcement (as in *NXP/Freescale*) and others that appeared to link antitrust enforcement with explicit concerns about Chinese national economic development (as in *Nokia/Alcatel* and the Qualcomm investigation). In this connection, it is notable that China's enforcement has focused specifically upon technology companies and how their licensing practices may impede Chinese manufacturers and other licensees doing business in China. In this sense, even if overall merger enforcement rates fell in China in the past year, there still remains a larger question regarding the degree to which Chinese antitrust enforcement will reflect ongoing concerns about domestic development within China.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Arthur J. Burke	212 450 4352	arthur.burke@davispolk.com
Joel M. Cohen	212 450 4592	joel.cohen@davispolk.com
Arthur F. Golden	212 450 4388	arthur.golden@davispolk.com
Ronan P. Harty	212 450 4870	ronan.harty@davispolk.com
Christopher B. Hockett	650 752 2009	chris.hockett@davispolk.com
Jon Leibowitz	202 962 7050	jon.leibowitz@davispolk.com
Mary K. Marks	212 450 4016	mary.marks@davispolk.com
Miranda So	+852 2533 3373	miranda.so@davispolk.com
Michael N. Sohn	202 962 7145	michael.sohn@davispolk.com
Howard Zhang	+86 10 8567 5002	howard.zhang@davispolk.com

© 2016 Davis Polk & Wardwell LLP | 450 Lexington Avenue | New York, NY 10017

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's [privacy policy](#) for further details.