China Antitrust Review 2016

January 25, 2017

Last year marked the eighth year of enforcement of China’s Anti-Monopoly Law (“AML”). As discussed below, the year was notable on a number of fronts.

China’s merger control authority, MOFCOM, issued a number of important merger decisions, although there were fewer such decisions than in prior years. In one horizontal case, Anheuser-Busch InBev’s acquisition of SABMiller, MOFCOM imposed only a divestiture requirement whereas the U.S. antitrust authorities required both divestiture and behavioral commitments. MOFCOM continued to conduct far lengthier reviews than U.S. and EU antitrust authorities, with several major transactions in which MOFCOM acted as the last “gatekeeper” following completion of U.S. and EU review.

Outside of merger enforcement, Chinese antitrust enforcement arguably expanded in scope, with China’s agency responsible for non-price conduct (SAIC) concluding that loyalty discounts could violate the AML, and publishing draft guidelines on intellectual property rights that appear to expand antitrust liability for patent holders in ways that differ from Western doctrine. Below, we review key developments and trends in 2016 for companies subject to AML enforcement.

I. Merger Control

A. Merger Control Decisions

In 2016, MOFCOM continued to increase its overall caseload and review of transactions. MOFCOM received 378 notifications (up 7.4% from 2015), reviewed 360 cases (up 6.5% from 2015), and closed 395 cases (up 19% from 2015). The manufacturing sector, including semiconductors, telecommunications, and other high-end manufacturing, accounted for over 50% of these cases.1 Similar to activity rates in 2015, MOFCOM blocked no deals and conditionally approved two: Anheuser-Busch InBev’s (“AB InBev”) acquisition of SABMiller and Abbott Laboratories’ acquisition of St. Jude Medical.

AB InBev/SABMiller. In July 2016, MOFCOM imposed a structural remedy for AB InBev’s $103 billion acquisition of SABMiller.2 MOFCOM appeared primarily concerned by an overlap between AB InBev and SABMiller’s 49% minority stake in China Resources Snow Breweries Limited (“CR Snow”), which was 51% majority owned by China Resources Beer (Holding) Company (“CRB”). Notably, CRB is a subsidiary of a state-owned enterprise (“SOE”) in China.

In its assessment of AB InBev/SABMiller, MOFCOM defined two product markets (“popular” and “premium/super-premium” beer) and two geographic markets (provincial and national). In the popular beer market, MOFCOM determined that as of 2014, AB InBev and CR Snow were the first- and third-largest players and would have a combined market share of 41%. In the premium beer market, it determined that CR Snow and AB InBev were the first- and second-largest players and would have a

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combined market share of 52%. In MOFCOM’s view, the transaction would have enhanced AB InBev’s control of the Chinese beer markets and reduced competition between AB InBev and CR Snow. It also determined that the transaction could raise barriers to entry for other beer producers by, among other things, consolidating control over beer sales channels. Importantly, the public version of MOFCOM’s assessment included no analysis of the fact that SABMiller’s stake in CR Snow was a minority one, or why CRB’s majority ownership could not curb the potential harms MOFCOM perceived. Instead, MOFCOM characterized the transaction as providing AB InBev with “joint control” of CR Snow with CRB.

As a condition of clearance, MOFCOM required that AB InBev sell its newly acquired 49% stake in CR Snow to CRB. MOFCOM did not impose any further behavioral remedies to accompany the divestiture. Notably, by contrast, in the U.S.—where AB InBev committed upfront to a divestiture of SABMiller’s U.S. business—the U.S. Department of Justice (“DOJ”) did impose behavioral remedies, including limitations on distributorship contract provisions. For example, AB InBev is prohibited from preventing distributors from exercising best efforts to sell or market competitors’ beers, providing incentives to distributors based on the distributors’ percentage of AB InBev beers sold compared to other competitor beers, or requiring distributors to sell competitors’ beers in a separate geographic area from AB InBev’s beers.

**Abbott Laboratories/St. Jude Medical.** On December 30, 2016, MOFCOM imposed a structural condition in clearing Abbott Laboratories’ (“Abbott”) $25 billion acquisition of St. Jude Medical (“St. Jude”). Abbott is a U.S. healthcare company focusing primarily on pharmaceutical and nutritional products, medical devices, and diagnostics, and St. Jude is a U.S. medical device company focusing on the cardiovascular sector. MOFCOM determined that the transaction would lead to a virtual monopoly in the Chinese market for vascular closure devices (which are used to close holes in arteries formed by the insertion of catheters), with Abbott controlling 71.3% and St. Jude controlling 23.9% of the market. MOFCOM required St. Jude to divest its vascular closure device business to Terumo, a Japanese medical device company. Days earlier, in the U.S., the Federal Trade Commission (“FTC”) required the same divestiture of St. Jude’s vascular closure device business to Terumo.

Several additional transactions are notable for the length of time that MOFCOM took to review the deals, with clearance coming significantly later than other global authorities:

**Dell/EMC.** In August 2016, MOFCOM cleared Dell’s $67 billion acquisition of EMC. The transaction, one of the largest-ever technology acquisitions, was cleared in February 2016 by both the FTC and the European Commission following a month-long review. By contrast, MOFCOM did not complete its review of the transaction within its own three-phase 180-day review period, causing the parties to refile up to six months after obtaining clearances elsewhere.

**Marriott/Starwood.** Similarly, in September 2016, MOFCOM cleared Marriott’s $13.4 billion acquisition of Starwood that created the largest hotel operator in China, albeit months after other global authorities completed their reviews. Marriott’s acquisition followed a bidding war with a major Chinese insurance company, Anbang Insurance (Anbang later bought Strategic Hotels & Resorts Inc. for $6.5 billion).

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with AB InBev/SABMiller and Dell/EMC, MOFCOM was the final antitrust regulator to clear the deal, following the transaction’s approval in over 40 other countries.

Commentators have suggested a number of reasons why MOFCOM reviews may take a relatively long time, including the involvement of other Chinese government agencies in the merger review process and short-staffing at MOFCOM. Additionally, practitioners have suggested that MOFCOM may on occasion wish to review economic analysis presented for other jurisdictions prior to conducting its own for the Chinese market. Regardless of the causes, the time that MOFCOM requires to complete transaction reviews relative to its peer agencies has become an important factor for parties to consider in setting global clearances strategies.

B. Termination of Merger Conditions

In June 2016, MOFCOM lifted all conditions imposed on Wal-Mart Stores Inc.’s ("Wal-Mart") 2012 acquisition of a controlling interest in Yihaodian, a Chinese grocery business. The conditions had limited Wal-Mart's acquisition solely to Yihaodian’s direct online sales and barred Wal-Mart from conducting business on Yihaodian’s third-party online sales platforms without government approval. More recently, however, MOFCOM found that the Chinese e-commerce market became more competitive, because the Ministry of Industry and Information Technology ("MIIT") in 2015 removed restrictions on foreign equity ratios in e-commerce to encourage foreign participation. It also found that Yihaodian had grown more slowly relative to its online platform rivals following MIIT’s lifting of restrictions. Given these circumstances, MOFCOM concluded that the restrictive conditions imposed on Wal-Mart were no longer necessary. Less than a month later, Wal-Mart sold Yihaodian to JD.com.

MOFCOM’s decision to lift conditions in Wal-Mart/Yihaodian reflects similar moves MOFCOM has made in recent years. In 2015, MOFCOM lifted the “hold separate” condition in Seagate/Samsung (2011) and partially lifted the “hold separate” in Western Digital/Hitachi (2012). MOFCOM still requires Western Digital and Hitachi to maintain separate sales teams and product brands.

C. Penalties for Reporting Violations

Like other jurisdictions, including the U.S., MOFCOM has authority to penalize parties who fail to comply with the reporting obligations specified in the AML, either by fining them up to RMB 500,000 (about $72,500) and/or unwinding an unreported transaction (though it has never exercised this latter authority).

In 2016, MOFCOM expanded its efforts to penalize companies for violating AML reporting requirements, imposing penalties for six transactions in 2016, compared with four in 2015. In particular, MOFCOM imposed larger fines on parties which it found had intentionally ignored the reporting requirements, reserving its largest fine so far—RMB 400,000 (about $58,000)—for Bombardier Transportation Sweden ("Bombardier") for its second violation of the reporting requirements in less than a year. Bombardier, a leading manufacturer of planes and trains, and New United Group ("NUG"), a high-tech enterprise involved in the railways sector, agreed to a 50/50 joint venture in 2015. Determining that the parties had intentionally failed to notify the agency in order to participate in a railway project tender, MOFCOM fined

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7 See “China Antitrust Review 2015.”
Bombardier RMB 400,000, a raise over its fine of RMB 150,000 (about $22,000) in 2015 for a similar violation. NUG received a RMB 300,000 penalty (about $43,500).

While such penalties represent an increase over 2015 in terms of enforcement cases, the penalties themselves remain notably smaller in China than in other jurisdictions. In the U.S., for example, the DOJ fined ValueAct $11 million in July 2016, and, in August 2016, the FTC fined Caledonia Investments $480,000, both for violating HSR notification requirements.

II. NDRC Enforcement Actions

NDRC, China’s antitrust body for price-related enforcement, has made international headlines in recent years for its large-scale investigations, including against Qualcomm. This past year, NDRC’s enforcement efforts appear to have centered on alleged price-fixing, joint boycotts, and market allocation by pharmaceutical companies and vertical pricing arrangements by medical device companies.8

NDRC’s focus on drug pricing follows two 2015 developments. First, the Chinese government abandoned its system of setting prices or price ceilings for most drugs.9 Second, NDRC announced that it would launch an investigation into drug pricing, including seeking out potential AML violations such as collusive pricing or abuse of dominance which led to drug sales at “unfairly high prices.”10 In May 2016, the agency announced a nationwide investigation into illegal drug pricing practices.11 By the end of the year, NDRC concluded three investigations into 14 domestic drug and chemical companies, imposing penalties of 1%-8% of annual gross sales for price-fixing and other collusive behavior.

In addition, in December 2016, NDRC fined Medtronic (Shanghai) Management Co., Ltd. (“Medtronic”) RMB 118.5 million ($17.2 million), or 4% of 2015 sales of relevant products, for entering vertical price arrangements with customers. NDRC concluded that since 2014, Medtronic, a leading Irish medical device company, has set resale prices, fixed profits on certain products, and issued bidding “guidance” for distributors, as well as setting minimum resale prices for hospitals.12

Beyond the health sector, 2016 saw NDRC continue its investigations into the auto industry, with a focus on resale price maintenance.13 In that connection, in May 2016, NDRC raided several Shanghai-based authorized dealers of U.S. carmakers General Motors and Ford.14 In December 2016, the Shanghai Municipal Development and Reform Commission fined SAIC General Motors Co., a joint venture between

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8 Additionally, Pfizer has received an inquiry from NDRC concerning possible excessive drug pricing, patent abuse, resale price maintenance and abuse issues in the company’s supply and distribution chain. PaRR, China’s NDRC Probes Pfizer for Possible Antitrust Violations, Sources Say (April 13, 2016), available at https://app.parr-global.com/intelligence/view/1386249.


13 See "China Antitrust Review 2015."

General Motors Company and SAIC Motor, RMB 201 million (about $29.1 million, or 4% of sales of 2015 relevant products) for engaging in resale price maintenance.  

III. SAIC Enforcement Actions

SAIC, China’s body for antitrust enforcement of non-price conduct, has most recently gained public attention for its ongoing investigation into Microsoft’s sales and marketing practices. In 2016, however, SAIC’s most notable enforcement activity concerned various business practices of Swiss packaging giant Tetra Pak. SAIC concluded, among other things, that loyalty discounts can pose anticompetitive concerns under the AML in certain instances—a conclusion similar to recent Western antitrust trends regarding loyalty discounts.

Tetra Pak. In November 2016, SAIC completed its nearly five-year-long investigation of Tetra Pak and various Chinese subsidiaries, concluding that Tetra Pak had abused its dominant position in the markets for aseptic packaging equipment, services, and materials. The agency imposed a penalty of RMB 667,724,176.88, or about $97 million (equivalent to 7% of Tetra Pak’s 2011 sales in China). The company said it would not appeal the decision. In reaching this penalty, SAIC determined that, from 2009 to 2013, Tetra Pak controlled over 50% of the market for equipment for liquid foodstuff, over 80% of the services market, and over 60% of the materials market. SAIC determined that Tetra Pak violated the AML by abusing these positions, as follows:

- **Tying**: SAIC found that Tetra Pak engaged in tying by requiring equipment and servicing customers to use its packaging materials in order to receive a guarantee on the performance of the equipment or services, without justifiable reason for imposing these conditions.
- **Exclusive dealing**: SAIC found that Tetra Pak prevented a paper supplier from supplying paper to third parties for the production of materials competitive with Tetra Pak’s.
- **Loyalty discounts**: SAIC found that Tetra Pak offered materials customers rebates and individualized sales target discounts, and that these discounts had the effect of locking in customer purchases and squeezing out other producers who could not match those discounts.

SAIC’s finding of an independent AML violation for the use of loyalty discounts is noteworthy. Antitrust liability for lower prices through loyalty discounts has become a controversial area of Western antitrust enforcement, and some precedents in recent years have found loyalty discounts or rebates offered by dominant market players to have anticompetitive effects under certain circumstances. In an older line of cases, including a U.S. Supreme Court case, Western authorities used a “price-cost” test to ask whether loyalty discounts are tantamount to anticompetitive below-cost pricing (“predatory pricing”). Several more recent agency settlements and lower court cases, however, have found that even above-cost discounts can pose anticompetitive effects in the form of foreclosure of competitors by virtue of exclusivity.

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arrangements (either explicit or de facto).\textsuperscript{18} SAIC’s decision makes no mention of whether Tetra Pak’s discounting was below any measure of cost, but the harms SAIC emphasizes—squeezing out other producers—suggests that SAIC may be influenced by the foreclosure theories of harm that have arisen in these more recent agency and lower court actions, such as the FTC’s 2010 settlement with Intel.

IV. Agency Draft Guidelines

\textbf{Intellectual Property.} In February 2016, SAIC published its seventh draft Intellectual Property Rights ("IPR") guidelines for public commentary. The SAIC IPR guidelines differ in a number of important ways from NDRC’s own draft IPR guidelines, released at the end of 2015. The draft guidelines from SAIC and NDRC have already generated much debate over their implication and meaning.\textsuperscript{19} Each set of guidelines indicates key departures from the traditional antitrust theory generally adopted by Western authorities:\textsuperscript{20}

\begin{itemize}
  \item \textbf{Safe harbors:} In determining whether an IPR undertaking can take advantage of SAIC’s safe harbor provisions, SAIC proposed to determine whether substitutable technologies controlled by third parties may be acquired at “reasonable costs,” a term that suggests an inquiry into the costs themselves. The U.S., by contrast, looks to “comparable cost” of substitutable technologies, a more market-based approach.
  
  \item \textbf{“Unfairly high” licensing rates:} Both SAIC and NDRC propose to limit “dominant” firms (i.e., firms with a greater than 50% market share) from imposing “unfair” royalty rates—a position with which commentators have taken issue because it suggests a regulation of rates or imposition of “price controls” independent of the marketplace.\textsuperscript{21}
\end{itemize}

\textsuperscript{18} Both the FTC and EC examined Intel’s offer of discounts conditioned on a customer’s percentage of volume purchased from Intel, as well as other allegedly exclusionary tactics employed by Intel, in concluding that Intel had intentionally excluded competitors from the relevant market. See “Intel Corporation; Analysis of Proposed Consent Order to Aid Public Comment” (August 10, 2010), available at https://www.ftc.gov/sites/default/files/documents/federal_register_notices/intel-corporation-analysis-proposed-consent-order-aid-public-comment/100810intelconsent.pdf; COMP/37.990 Intel, § 4.2.3 (May 13, 2009), available at http://ec.europa.eu/competition/sectors/ICT/intel_provisional_decision.pdf. The Third Circuit has also examined a dominant market player’s use of above-cost loyalty discounts and found that they contributed to de facto exclusive dealing. \textit{ZF Meritor, LLC v. Eaton Corp.}, 696 F.3d 254, 281 (2012). The \textit{ZF Meritor} court noted that a range of elements contained in the company’s purchase agreements constituted de facto exclusive dealing, such as the company maintaining the option of terminating its supply agreement with a customer if that customer did not meet a percentage purchasing target. \textit{Id.} at 265-67, 281.


\textsuperscript{21} See, e.g., Bill Baer, \textit{Remarks at the 19th Annual International Bar Association Competition Conference} (Sept. 11, 2015), available at https://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-delivers-remarks-19th-annual-international-bar ("We don’t use antitrust enforcement to regulate royalties. That notion of price controls interferes with free market competition and blunts incentives to innovate. For this reason, U.S. antitrust law does not bar ‘excessive pricing’ in and of itself. Rather, lawful monopolists are perfectly free to charge monopoly prices if they choose to do so.”).
Essential facilities: Both SAIC and NDRC propose to adopt an essential facilities doctrine under certain circumstances. Unlike in the U.S., SAIC’s and NDRC’s positions could potentially lead to a patent-holder’s unilateral refusal to license being found to constitute an antitrust violation.

Standard essential patents (“SEPs”): SAIC’s guidelines enumerate a number of proscribed actions taken by SEP holders who maintain a dominant market position. For example, the SAIC rules prohibit a SEP-holding firm from “deliberately fail[ing] to disclose” information regarding its IPRs to a standard-setting organization, and prohibit such firm from engaging in conduct which violates FRAND principles, even if the firm is not contractually bound to them. The guidelines also make no reference to any potentially procompetitive benefits of standard-setting, thus departing from the U.S.’s preferred rule-of-reason approach to SEP-related antitrust issues.

Patent pools: Similar to its treatment of SEPs, the SAIC guidelines do not adopt a rule-of-reason approach to patent pools, making no mention of their procompetitive benefits. In fact, under certain circumstances, the SAIC guidelines appear to adopt a presumption that conduct by patent pool members with dominant market power violates the AML unless the patent pool members can prove otherwise.

In addition to the SAIC and the NDRC IPR guidelines, MOFCOM and the State Intellectual Property Office have also been tasked with developing their own draft guidelines. The four drafts are to be reviewed by the Anti-Monopoly Commission and potentially integrated together. It remains to be seen what the final IPR guidelines will look like.

V. Conclusion

In 2016, Chinese antitrust authorities extracted fewer remedies in merger reviews and did so without some of the behavioral remedies that China has used in recent years, even removing the behavioral remedies it had imposed in Wal-Mart/Yihaodian. At the same time, China appears to have focused more on imposing fines for failure to comply with AML reporting requirements, and it continues in certain high-profile cases to take significantly longer to complete merger review than its peer agencies. On the conduct side, China has moved beyond its focus on technology industry in 2016 to extract meaningful remedies in industries from pharmaceuticals to packaging equipment.

As in recent years, one of the major questions for companies subject to antitrust enforcement in China is whether China will adopt Western norms and priorities for antitrust enforcement or whether, as in the debate over the intellectual property guidelines, it may take positions that stand in stark contrast to the enforcement philosophies of other nations. This open question will require companies conducting business or notifying a transaction in China to carefully consider global strategy in light of concerns that may at times be China-specific.

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22 An “essential facility” is “an input without which a firm cannot compete with [a] monopolist…. [T]he asset in question must not be available from other sources or capable of duplication by the firm seeking access.” Hooks, Patterson, and Pitofsky, The Essential Facilities Doctrine Under United States Antitrust Law, 70 ANTITRUST L.J. 443, 449-50 (2002). Generally speaking, “U.S. courts rarely find liability under the essential facilities doctrine” where a holder of an potentially “essential” input refuses to deal with a competitor. Id. See also Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 407-08 (2004).

23 Hockett and Solomon, at 2, 7.
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