

China Antitrust Review 2020

January 28, 2021

2020 marked the twelfth anniversary of China's Anti-Monopoly Law (the “**AML**”). Over the course of the past year, the Chinese authorities made it clear that they expect to be full participants in the ongoing international dialogue regarding competition enforcement and policy for internet platforms, both with respect to mergers and business conduct in the digital realm. The past year also saw potentially significant changes in Chinese antitrust enforcement activity, with the highest-ever monetary penalties imposed and high-profile enforcement actions targeting internet platform operators. The State Administration for Market Regulation (“**SAMR**”) published Draft Anti-Monopoly Guidelines on the Sector of Platform Economies, which may well lead to increased scrutiny of mergers by internet platforms—particularly of smaller or “nascent” competitors. The Draft Guidelines also highlight concerns about exclusionary provisions related to online sales.

The Chinese authorities continue to stress that they are significant actors in the international merger control regime. In 2020, with subsequent revisions in January 2021, SAMR published a proposed amendment to 2008’s Anti-Monopoly Law (“**Draft AML Amendment**”), which substantially increases the penalties for failing to notify a transaction. The Draft AML Amendment also effectively insulates SAMR from statutory merger review timelines, which may lead to an extension of the duration of merger reviews in China. We expect the Draft AML Amendment to be enacted this year.

We describe below the key developments in antitrust regulations and the notable enforcement actions of 2020.

I. Updates to the AML and SAMR Regulations

A. *Draft AML Amendment*

On January 2, 2020, SAMR officially published the Draft AML Amendment for public comment. SAMR subsequently published a revised draft on January 20, 2021. The Draft Amendment marks the first time that the government will make major changes to the AML since it became law in 2008. Although there is no fixed timetable for formal adoption, the Legislative Affairs Commission of the Standing Committee of the National People’s Congress noted that it would be a priority for 2021.¹

One of the most significant developments in the Draft AML Amendment is the increased maximum penalties for merger control violations (including failure to notify and gun-jumping violations). Under the Draft Amendment, the statutory maximum fine for merger control violations is 10% of the company’s revenue in the last fiscal year, reflecting a dramatic increase from RMB 500,000 (approximately USD

¹ Spokesperson of the Legislative Affairs Commission of the Standing Committee of the National People’s Congress: the National People’s Congress Will Strengthen Legislation in Key Areas, Emerging Areas, and Foreign-Related Fields in 2021 (法工委发言人：明年全国人大将加强重点领域、新兴领域、涉外领域立法) (December 20, 2020), available at <http://www.npc.gov.cn/npc/c30834/202012/f4fd27270f78471dbe8f88c31c47cb0f.shtml> (Chinese language).

77,000) under the current AML rules.² The increased penalties for failure to file may result in an uptick in the number of merger review filings in China. This provides an even greater incentive for businesses to review carefully transactions potentially requiring notification in China.

Furthermore, a “stop-the-clock” mechanism in the Draft AML Amendment allows SAMR to extend the statutory timeline for merger reviews if: (i) the filing parties apply for or agree to a suspension of the merger review; (ii) SAMR has requested supplemental materials from the filing parties; or (iii) the filing parties are in negotiation with SAMR regarding potential remedies for conditional approvals. The wide discretion provided to SAMR to suspend the statutory timeline insulates SAMR from time pressure, and may result in a further lengthening of merger review in China. This may impede companies in their efforts to resolve merger reviews by SAMR in a timely manner.

B. *Draft Anti-Monopoly Guidelines on the Sector of Platform Economies*

On November 10, 2020, SAMR released the Draft Anti-Monopoly Guidelines on the Sector of Platform Economies (“**Draft Guidelines**”), which directly target the internet sector.³ Historically, SAMR and its predecessors have taken a generally hands-off approach with respect to this business segment. The Draft Guidelines signal SAMR’s heightened concerns over the growing influence of the major internet platform companies. Once implemented, we expect that the Draft Guidelines will likely result in: (i) an uptick in the number of merger filings by internet companies, especially given the recent fines handed out to major Chinese digital platform operators for failing to file (see Section II.B); (ii) increased scrutiny of acquisitions by large platforms, particularly where the acquired company may be considered to be an emerging threat; (iii) enhanced skepticism about exclusivity provisions and other vertical restraints related to online sales; and (iv) continued refinement of what constitutes abuse of dominance in the platform economy.

1. **Merger Control**

The Draft Guidelines address several merger control issues, including (i) the regulation of mergers involving the variable interest entity (“**VIE**”) structure, and (ii) SAMR’s ability to review certain transactions when the merging filing thresholds are not met.

- **VIE Structures.** Under a VIE structure, the controlling party does not own shares of the operating entity (i.e., VIE), but achieves *de facto* control of business operations and finances through a series of agreements. Article 18 of the Draft Guidelines makes clear that mergers involving a VIE structure must file for SAMR’s review if the merger notification obligation is triggered. The application of SAMR’s review to the VIE Structure was subsequently also incorporated into Article 28 of the Draft AML Amendments promulgated on January 20, 2021.
- **Acquisition of Emerging Companies.** Article 19 of the Draft Guidelines grants SAMR broad discretion to investigate transactions by internet platform companies where the turnover is below the statutory thresholds for merger notification. Specifically, the Draft Guidelines allow SAMR to

² The Draft AML Amendment does not specify whether the 10% figure is to be calculated from global revenues or China-only revenues and so the 10% figure may be calculated based on a company’s global revenues in theory. Given the Draft AML Amendment has not yet become effective, how aggressive an approach SAMR will take on monetary penalties remains an open question.

³ SAMR Draft Anti-Monopoly Guidelines for the Platform Economy Industry (市场监管总局关于《关于平台经济领域的反垄断指南（征求意见稿）》公开征求意见的公告) (November 10, 2020), available at http://www.samr.gov.cn/hd/zjdc/202011/t20201109_323234.html (Chinese language).

initiate an investigation when one party of the transaction is a startup or an emerging platform. A similar provision was subsequently incorporated into Article 28 of the Draft AML Amendments promulgated on January 20, 2021. Article 19 of the Draft Guidelines and Article 28 of the Draft AML Amendments are consistent with concerns expressed in other jurisdictions, including in the European Union and United States, over so-called “killer acquisitions” (i.e., incumbent companies preempting future competition by acquiring innovative emerging companies).

2. Vertical Agreements

The Draft Guidelines suggest increased scrutiny of vertical agreements in the internet platform economy. In particular, Article 7 highlights that most-favored-nation provisions and exclusivity agreements between the platform and the business operators on the platform could constitute vertical monopoly agreements. It also suggests that data, algorithms, or other technical means may be used as tools of monitoring and maintaining compliance with those vertical agreements. A similar provision was subsequently incorporated into Article 23 of the Draft AML Amendments promulgated on January 20, 2021.

These revisions in China are consistent with increased scrutiny of vertical agreements around the world, including a possible revision to the European Union’s Guidelines on Vertical Restraints to address online sales, as well as the U.S. Department of Justice’s challenge to certain of Google’s vertical agreements.

3. Abuse of Dominance

Articles 12 to 17 of the Draft Guidelines highlight specific conduct by internet platforms that may constitute an abuse of dominance, such as personalized pricing based on users’ shopping history and personal information, and retaliatory restrictions on internet traffic against uncooperative operators. The Draft Guidelines provide certain exemptions for internet platform companies to engage in these behaviors, so long as there are “legitimate reasons.” For example, with respect to personalized pricing, internet platform companies may be allowed to provide personalized discounts for new users within a reasonable period of time. The significant ambiguity within the guidelines makes it too early to tell whether the Draft Guidelines would affect the business practices of major internet companies in China, but we would expect that SAMR would continue to refine the applicable law on abuse of dominance and in appropriate cases may bring enforcement actions to define the contours of prohibited conduct.

II. Merger Control

A. Merger Control Decisions

During the past year, SAMR imposed remedies in four transactions. As in 2019, SAMR did not block any transactions in 2020. SAMR continues to rely primarily on a variety of behavioral remedies, including non-discrimination commitments. SAMR imposed a structural remedy in only one challenged transaction. This approach continues to differ from other jurisdictions, which have announced strong preferences for structural remedies. Consistent with past enforcement actions, SAMR imposed conditions on mergers in the semiconductor and pharmaceutical supply industries, perhaps reflecting additional scrutiny placed on mergers in “strategic” industries. Below we highlight three of the transactions in which SAMR imposed conditions.

Danaher/GE Biopharma

In February 2020, SAMR imposed primarily structural remedies in the acquisition by Danaher Corporation (“**Danaher**”) of the biopharma business of General Electric Company (“**GE Biopharma**”).⁴ Danaher and GE Biopharma are leading suppliers in the global and Chinese continuous chromatography system markets. SAMR concluded that the acquisition would greatly increase concentration in global markets for several products used in the manufacture of biopharmaceutical drugs. To resolve SAMR’s concerns, Danaher was required to divest several business segments of Danaher and to provide transitional support to the divested assets.

Infineon/Cypress

In April 2020, SAMR imposed behavioral remedies on the acquisition by Infineon Technologies AG (“**Infineon**”) of Cypress Semiconductor Corporation (“**Cypress**”).⁵ SAMR concluded that the acquisition would increase concentration in several markets for automotive-grade circuits. Among the remedies imposed, SAMR required the parties to provide the relevant products to Chinese customers on fair, reasonable, and non-discriminatory terms; to refrain from tying sales of the relevant products in China; and to ensure that the relevant products sold to Chinese customers comply with the industry standards.

Nvidia/Mellanox

In April 2020, SAMR imposed behavioral remedies on Nvidia Corporation’s (“**Nvidia**”) acquisition of Mellanox Technologies Ltd (“**Mellanox**”), both operating in the markets for data center servers and ordinary Ethernet adaptors.⁶ SAMR concluded that the acquisition would increase concentration in the markets for GPU accelerators, special network interconnection devices, and high-speed Ethernet adaptors. To resolve these concerns, SAMR required the transacting parties to provide the relevant products to Chinese customers on fair, reasonable, and non-discriminatory terms; to refrain from tying or bundling the relevant products in China; to ensure the interoperability of the relevant products with third parties; and to respect their existing open-source commitments.

B. *Penalties for Failure to File*

SAMR has authority to penalize parties who fail to comply with the reporting obligations set forth in the AML by imposing a fine up to RMB 500,000 (approximately USD 77,000) and/or by demanding that parties involved unwind the transaction. In the past year, SAMR imposed failure to notify penalties on 12 transactions, including three cases involving internet companies. This compares to a total of 17 penalty

⁴ Announcement of the State Administration for Market Regulation: Announcement of the Anti-Monopoly Review Decision to Approve, with Restrictive Conditions, the Concentration of Undertakings in Respect of the Acquisition of the Biopharma Business of the General Electric Company by Danaher Corporation (February 28, 2020), available at http://www.samr.gov.cn/fldj/tzgg/ftjpz/202002/t20200228_312297.html (Chinese language).

⁵ Announcement of the State Administration for Market Regulation: Announcement of the Anti-Monopoly Review Decision to Approve, with Restrictive Conditions, the Concentration of Undertakings in Respect of the Acquisition of Cypress Semiconductor Corporation by Infineon Technologies AG (April 8, 2020), available at http://www.samr.gov.cn/fldj/tzgg/ftjpz/202004/t20200408_313950.html (Chinese language).

⁶ Announcement of the State Administration for Market Regulation: Announcement of the Anti-Monopoly Review Decision to Approve, with Restrictive Conditions, the Concentration of Undertakings in Respect of the Acquisition of Mellanox Technologies Ltd by Nvidia Corporation (April 16, 2020), available at http://www.samr.gov.cn/fldj/tzgg/ftjpz/202004/t20200416_314327.html (Chinese language).

cases in 2019. Of the 12 transactions during this past year, only two transactions involved foreign parties (down from seven in 2019).

Fines on Internet Companies

In connection with issuing the Draft Guidelines, SAMR increased the scrutiny of transactions involving digital platform operators. On December 14, 2020, the SAMR imposed a fine of RMB 500,000 (approximately USD 77,000) on each of Alibaba Investment (for its investment in investment in Intime Retail), China Literature (for its acquisition of New Classics Media), and Shenzhen Hive Box Network Technology (for its acquisition of China Post Logistics Technology), for failing to notify SAMR of the transactions. These actions are the first time that SAMR has fined transactions involving the VIE structure (discussed above), which has been commonly used by China-based internet companies to raise foreign capital and to list on overseas stock exchanges.

III. SAMR Conduct Enforcement Actions

Continuing its trend from prior years, SAMR and its local branches brought multiple enforcement actions in the pharmaceutical industry, especially with respect to suppliers of active pharmaceutical ingredients.

A. Active Pharmaceutical Ingredients Enforcement Action

In this case, SAMR investigated three companies, Shandong Kanghui Medicine, Weifang Puyunhui Pharmaceutical, and Weifang Taiyangshen Pharmaceutical that collectively control more than 87% of the distribution of active pharmaceutical ingredients for injectable calcium gluconate. During the investigation, SAMR found that between August 2015 and December 2017, the three firms abused their dominant position in the Chinese market by selling at an unfairly high price. The agency also found that the three companies violated the AML by imposing unreasonable trading terms. For example, according to the SAMR, the defendants threatened downstream manufacturers with termination or reduced supply if they did not sell the finished product back to the defendants. On April 9, 2020, SAMR fined the three companies an aggregate amount of RMB 204.5 million (approximately USD 31.6 million). This represents a record monetary penalty against domestic firms by Chinese antitrust authorities.⁷ On top of the fines, SAMR also required disgorgement of RMB 121 million (approximately USD 18.7 million).⁸

B. Ongoing SAMR Investigations

On December 11, 2020, a meeting of the Political Bureau of the Central Committee of the Communist Party of China concerning China's economic policy for 2021 emphasized that China would "enhance antitrust efforts and prevent the disorderly expansion of the capital."⁹ Consistent with this statement, on December 24, 2020, SAMR announced that it had opened an investigation into Alibaba Group Holding

⁷ SAMR's Decision Regarding Calcium Gluconate Active Pharmaceutical Ingredient Suppliers for Abuse of Dominance (市场监管总局发布葡萄糖酸钙原料药垄断案行政处罚决定书) (April 14, 2020), available at http://www.samr.gov.cn/fldj/tzgg/xzcf/202004/t20200414_314227.html (Chinese language).

⁸ SAMR Fines Shandong Kanghui Medicine, Weifang Puyunhui Pharmaceutical and Related Individuals for Hindering Antitrust Probe (市场监管总局发布山东康惠医药有限公司、潍坊普云惠医药有限公司及相关人员拒绝、阻碍反垄断调查违法行为行政处罚决定书) (April 14, 2020), available at http://www.samr.gov.cn/fldj/ajgs/jzjyajgs/202004/t20200420_314431.html (Chinese language).

⁹ Key Meeting Stresses Anti-Monopoly Stance, Orderly Expansion of Capital, Global Times (December 13, 2020), available at <https://www.globaltimes.cn/content/1209782.shtml>.

(“Alibaba”) for suspected monopolistic conduct.¹⁰ In a one-sentence press release issued by SAMR, the agency indicated that it launched the investigation following complaints received against Alibaba. According to SAMR, it will target the practice described as “choose one from two” that forces vendors to enter into exclusive sales contracts with Alibaba and other unspecified issues. As of the date of this client memorandum, the investigation is still ongoing and SAMR has not yet released further information regarding the Alibaba investigation.

IV. Conclusion

In 2020, China demonstrated through legislative, regulatory, and enforcement means its resolve to address competition issues in the digital world including those involving the VIE structure, and its continued willingness to deviate from certain Western practices such as use of behavioral remedies in horizontal cases. A dozen years into its antitrust regime, China appears to be signaling an openness to expanding both the reach and the severity of its enforcement system.

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¹⁰ SAMR Investigates Alibaba for Alleged Monopolistic Behavior (市场监管总局依法对阿里巴巴集团涉嫌垄断行为立案调查) (December 24, 2020), available at http://www.samr.gov.cn/xw/zj/202012/t20201224_324638.html (Chinese language).