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Antitrust in China – 2021 Year in Review

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Happy New Year of the Tiger to our clients and friends!

2021 was the year where the PRC Government launched a broad regulatory assault on Chinese "Big Tech" companies. The State Administration for Market Regulation ("SAMR") did its part by imposing significant fines on Alibaba and Meituan for abuses of dominance, and administrative penalties in more than 100 cases for failure to notify, over 80 of which involved platform companies, such as Alibaba, Baidu, Didi, Meituan, Suning, and JD.com. The Government also released the Anti-Monopoly Guidelines for the Platform Economy Sector in February 2021 to provide guidance on enforcement in the tech space.

On the merger front, SAMR reviewed approximately 700 transactions, imposed remedies on four of them, and, more significantly, blocked one transaction – this is only the third time that China's antitrust authority has ever done so.

2022 should see a continued increase in antitrust enforcement. In this respect, SAMR's Anti-Monopoly Bureau has been elevated in the Chinese bureaucracy, which signals its importance to the Government.

The Government also published its Draft Amendment to the Anti-Monopoly Law ("AML") for public comment in October 2021 and the proposed changes could be adopted in 2022.

1. Legislative / Regulatory Developments

Anti-Monopoly Guidelines for the Platform Economy Sector ("Platform Guidelines"). In February 2021, SAMR issued specific guidance on the applicability of the AML to digital platforms, including e-commerce and social media companies. The Platform Guidelines confirm that transactions involving variable interest entities ("VIE") are subject to merger review, and grant SAMR broad discretion to investigate transactions involving digital platforms. They also set out the types of agreements that may constitute monopoly agreements in the platform economy context, some of which go beyond the traditional written or verbal agreements or meeting of minds. For example, under the Platform Guidelines, the use of technical methods, data, and algorithms may constitute a horizontal or vertical monopoly agreement, and a most favoured nation ("MFN") clause may constitute a vertical monopoly agreement. In addition, the Platform Guidelines provide that an undertaking's ability to control and process data will be taken into account by SAMR when reviewing abuse of dominance cases, both in assessing market dominance and in analysing conduct (e.g. an undertaking penalizing uncooperative operators with traffic restrictions or search downgrades).

For more detail on the Platform Guidelines, please refer to our client alert, Antitrust in China – 2020 Year in Review, published on March 4, 2021.

Draft Amendment to the Anti-Monopoly Law ("Draft Amendments to the AML"). After over a decade, China has taken a major step towards introducing critical changes to the AML, which came into force in 2008. Following SAMR's publication of the first draft of the

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amendments to the AML in early 2020, the Standing Committee of the National People's Congress ("NPCSC") released its Draft Amendments to the AML for public consultation on October 23, 2021. The public consultation period closed on November 21, 2021.

The Draft Amendments to the AML propose changes that affect all aspects of the AML, including merger control, non-merger enforcement, and procedural rules. In particular, they impose significantly harsher penalties on undertakings for failure to file, and introduce fines against individuals for engaging in anticompetitive behaviour.

Moreover, the Draft Amendments to the AML propose new provisions targeting platform companies, specifically noting that (1) undertakings "shall not exclude or restrict competition by abusing the advantages in data and algorithms, technology and capital and platform rules," and that (2) it would be considered an abuse of dominance if an undertaking with a dominant market position "uses data, algorithms, technologies and rules of the platform to erect obstacles and impose unreasonable restrictions on other undertakings." The new provisions signal the continued focus of China's antitrust enforcement on the platform economy.

Other notable proposed amendments include the introduction of the "stop-the-clock" mechanism (thus giving SAMR greater flexibility to extend the merger review process), abandoning the *per se* treatment of resale price maintenance (though the burden of proof lies with undertakings), providing a safe harbour for monopoly agreements, and expressly imposing liability on cartel facilitators.

In terms of next steps, the NPCSC will review the feedback received and further deliberate on the amendments before signing them into law. While there is no official announcement on the timing, it is expected that the NPCSC would finalize and pass the amendments in 2022.

For more detail on the Draft Amendments to the AML, please refer to our client alert, China Publishes Draft Amendment to the Anti-Monopoly Law, published on October 27, 2021.

Elevation of Status of Anti-Monopoly Bureau. In November 2021, the Anti-Monopoly Bureau, which was a subdivision under SAMR, was promoted to the deputy ministerial level. While the Bureau remains subject to SAMR supervision, this elevated status ensures that it will benefit from increased manpower and budget and demonstrates the Chinese government's commitment to further strengthening antitrust enforcement.

Under the revamped organization, the deputy ministerial-level agency contains three divisions that focus on (1) policy implementation, (2) merger control and investigation of gun-jumping, and (3) supervision of monopoly agreements and abuse of market dominance. Most notably, in the latter two divisions, there is a subdivision that specifically targets the platform economy, further underscoring China's determination to closely scrutinize potential anticompetitive behaviour in the technology sector.

2. Merger Control

In 2021, SAMR unconditionally approved more than 99% of approximately the 700 deals it reviewed and imposed conditions in only four transactions. However, it blocked one transaction—the proposed merger between HUYA Inc. ("Huya") and DouYu International Holdings Limited ("DouYu"). This is only the third time that a Chinese antitrust authority has blocked a merger since the inception of China's merger control regime in 2008.

Like in 2020, SAMR took on average 14-15 days to complete its review of cases under the simplified procedure. It took an average of 288 days to complete its review of conditionally approved cases, and 187 days to complete its review of the single blocked transaction.

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Separately, SAMR announced that they penalized parties in almost 100 transactions for failure to notify. This represents a nearly sevenfold increase in the number of failure to notify cases compared with 2020.

2.1 Prohibition Decision

In July 2021, SAMR prohibited the proposed merger between Huya, a company controlled by Tencent, and DouYu, in which SAMR found Tencent exercised joint control with DouYu's founder team. Both companies provide videogame live-streaming services. According to SAMR, the proposed merger effectively gave Tencent sole control over DouYu.

In its review, SAMR found that the proposed merger would result in the merged entity having a market share of over 70% by turnover, 80% by number of active users, and 60% by number of live streamers. Given the significant post-merger market shares and that the videogame live-streaming market has high entry barriers, SAMR concluded that the proposed merger would strengthen Tencent's dominant position and restrict or eliminate competition in the videogame live-streaming market.

SAMR's review also found that post-merger, Tencent would have the ability and incentive to implement a two-way vertical foreclosure in both the upstream online-game operator market and the downstream videogame live-streaming market, given Tencent's existing market share of over 40% in the upstream market and the merged entity's significant market share in the downstream market noted above. Specifically, SAMR contended that:

1. Tencent, as an online-game operation service provider, owns online-game copyright licenses that are critical for the downstream videogame live-streaming market. Post-merger, Tencent would have the ability and incentive to foreclose downstream competitors by, for example, precluding their access to copyright licenses, thereby restricting or eliminating competition in the downstream videogame live-streaming market.
2. As videogame live-streaming is an effective channel to promote videogames of upstream online-game operation service providers, Tencent would have the ability and incentive to preclude upstream competitors from having the live-streaming channels promote their games, thereby restricting or eliminating competition in the upstream online-game operation service provider market.

2.2 Conditional Approval Decisions

Cisco Systems Inc. ("Cisco") / Acacia Communications Inc. ("Acacia"). In January 2021, SAMR imposed behavioural conditions on Cisco's proposed acquisition of Acacia. SAMR found competition concerns resulting from the vertical relationship between the parties, namely Acacia being in the upstream global market for coherent digital signal processors ("DSP") and Cisco being in the downstream Chinese market for optical transmission systems. To remedy these concerns, the parties offered a number of commitments, to which SAMR agreed, including the following: (1) to continue performing all existing contracts; (2) to continue supplying coherent DSP to Chinese customers on fair, reasonable and non-discriminatory ("FRAND") terms; and (3) not to bundle, tie, or impose unreasonable conditions in the supply of coherent DSP.

Danfoss A/S / Eaton Corporation. In June 2021, SAMR imposed structural conditions on Danfoss's acquisition of Eaton's hydraulic business. SAMR concluded that the proposed transaction would increase the concentration in China's orbital motor market given that, among other considerations, (1) the parties are the two largest players in the market with a combined market share of 50% to 55%, such that the combined entity would have a dominant position in the market; (2) the parties are each other's closest competitor and the proposed transaction would remove competitive restraints; and (3) the proposed transaction would raise market entry barriers given the parties' existing advantages (e.g.

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reputation). To resolve these competition concerns, Danfoss agreed to divest its orbital motor business in China.

Illinois Tool Works Inc. ("ITW") / MTS Systems Corporation ("MTS"). In November 2021, SAMR imposed behavioural conditions on ITW's proposed acquisition of MTS. The proposed transaction would result in ITW obtaining sole control over MTS. SAMR identified competition concerns in the high-end electrohydraulic servo material testing equipment market, as the parties have a combined market share of 65% to 70%. SAMR imposed a range of behavioural remedies on the parties, including (1) to continue performing all existing contracts with Chinese customers and maintaining the same level of service quality for them; and (2) to maintain prices for the relevant testing products in China no higher than their average price within the past 24 months.

SK Hynix Inc. ("SK Hynix") / Intel Corporation ("Intel"). In December 2021, SAMR imposed behavioural conditions on SK Hynix's acquisition of Intel's NAND memory chip business. In its review, SAMR defined the relevant markets as the worldwide and China markets of (1) peripheral component interconnect express ("PCIe") enterprise-class solid-state disk ("SSD"); and (2) serial advanced technology attachment ("SATA") enterprise-class SSD. It concluded that the proposed transaction would give rise to competition concerns given the higher degree of market concentration post-acquisition (over 30% globally and over 50% in China), a decrease in the number of major players in the relevant markets post-acquisition (from three to two in the PCIe enterprise-class SSD market and from four to three in the SATA enterprise-class SSD market), and high barriers to entry.

To resolve these concerns, SAMR imposed a number of behavioural conditions on the combined entity, including the following: (1) to continue expanding the quantity of production of the two types of SSDs in the next five years; (2) to maintain prices for the relevant products at or below their average price over the past 24 months; (3) to continue supplying all products in China on FRAND terms; (4) to refrain from exclusive dealing, bundling, or tying when supplying products in China; (5) to refrain from entering into any agreement, or engage in any concerted act, with major competitors in China on price, output, or sales volume; and (6) to assist a third-party competitor to enter the two markets.

2.3 Enforcement Against Non-Notified Transactions

In 2021, SAMR issued a fine for failure to notify in almost 100 cases, 84 of which involved platform companies. Approximately 90% of all cases received the maximum fine of RMB 500,000 (~USD 78,642), while the remaining cases received a fine of at least RMB 150,000 (~USD 23,593). SAMR also imposed remedies in one failure to file case.

3. Non-Merger Enforcement

As they have done in recent years, SAMR and its local bureaus continued to target the pharmaceutical sector in a wide range of enforcement actions, including abuse of a dominant position, resale price maintenance, price fixing, and market allocation. SAMR's enforcement against pharmaceutical companies in 2021 remained focused on Chinese Active Pharmaceutical Ingredients ("API") manufacturers, such as the imposition of a RMB 100.7 million (~USD 15.8 million) fine on the country's leading supplier of batroxobin API, the Hong Kong-listed Simcere Pharmaceutical, for abuse of a dominant position in China's batroxobin API market through refusal to supply.

Moreover, there were a series of enforcement actions targeting platform companies in 2021, once again demonstrating SAMR's close regulatory scrutiny of the platform economy sector. Two of the cases stood out in particular due to the scale of the business and the significant amount of fine:

1. In April 2021, SAMR imposed a fine of RMB 18.228 billion (~USD 2.87 billion) on Alibaba for abuse of a dominant position. The fine amounted to 4% of Alibaba's

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annual sales in China in 2019. SAMR's investigation concluded that Alibaba prohibited merchants from operating stores or participating in promotional activities on Alibaba's rival platforms, and implemented a reward and penalty mechanism on the merchants' compliance (e.g. by downgrading online ratings of merchants who refused to comply).

2. In October 2021, SAMR imposed a fine of RMB 3.44 billion (~USD 541 million) on China's food delivery giant, Meituan, for abusing its dominant position. This amounted to 3% of Meituan's 2020 turnover in China. SAMR found that Meituan punished merchants who refused to comply with Meituan's exclusivity agreements by charging these merchants high commission rates and granting them less exposure on Meituan's platform.

Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Antitrust and Competition Practice Group, or the following authors in the firm's Hong Kong office:

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