

## China: Landmark Anti-Monopoly Law reforms signal more modernized antitrust enforcement

### In brief

On 24 June 2022, China's National Peoples' Congress approved far reaching amendments to China's Anti-Monopoly Law<sup>1</sup> ("**AML**") which become effective from 1 August 2022 ("**AML Amendments**").

Alongside the AML Amendments, the State Administration for Market Regulation ("**SAMR**") has issued for public comment proposed updates to key implementing rules and regulations concerning cartels and vertical restraints, abuse of dominance, merger control and abuse of IP rights.

The following are of particular relevance to business operations in China and M&A activity:

- Stricter penalties for antitrust violations including tougher fines for gun-jumping (RMB 5 million for non-problematic transactions, or up to 10% of total group turnover for transactions with competition concerns), monetary penalties up to RMB 1 million for individuals (senior leadership and employees directly responsible) for antitrust violations, and potential criminal liability of both companies and individuals if conduct constitutes a crime violating the Criminal Law.
- Increased enforcement powers: formally granting SAMR power to summon companies to urge them to agree to antitrust compliance and mitigating measures outside the antitrust investigation procedure, and introducing public interest litigation initiated by people's procuratorate against antitrust violations.
- Revised thresholds for merger control, including: proposed increases in the turnover thresholds, new hybrid thresholds based on turnover and market value, emphasizing SAMR's power to require deals to be notified where the parties do not meet the jurisdictional thresholds and new powers for SAMR to "stop the clock" in merger reviews.
- Express prohibition of hub-and-spoke arrangements, codifying prior enforcement practice.
- Potential exemptions / defences for resale price maintenance ("**RPM**") and non-price vertical restraints.
- Continued scrutiny of the platform economy focused on the use of data, algorithms, technologies, capital advantage, and platform rule setting.

It is the right timing to reinvent antitrust compliance:

- Identify the business lines with more exposure in in the China market.
- Spot potential risks and consider if and what mitigating measures might be adopt to avoid the higher penalties/serious legal consequences.

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#### Background

<sup>1</sup> The full version is available in Chinese at <http://www.npc.gov.cn/npc/c30834/202206/e42c256faf7049449cdfaabf374a3595.shtml>, and an official press release in English at [http://en.npc.gov.cn.cdurl.cn/2022-06/27/c\\_784677.htm](http://en.npc.gov.cn.cdurl.cn/2022-06/27/c_784677.htm).

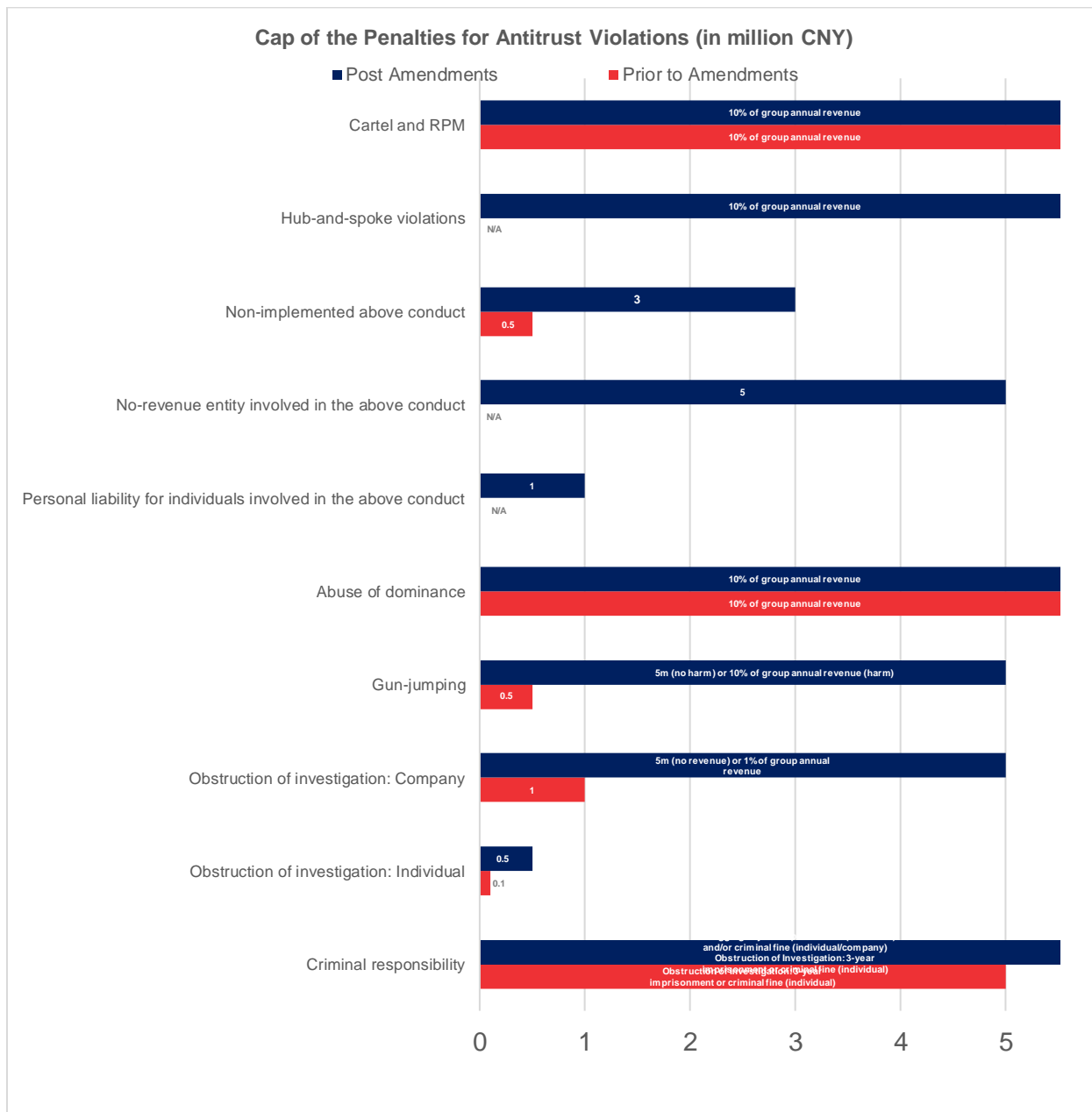


- Plan your deal timetable subtly.

## Key takeaways

### 1. Tougher penalties under the amended AML

A summary of the steep increase in penalties for antitrust violations is as follows:





## 2. A more robust merger review process

The AML Amendments and accompanying SAMR draft regulations put forward the following important procedural reforms to Chinese merger control rules:

- **Revised thresholds:** the SAMR has published draft regulations that would marginally raise the existing turnover thresholds for merger control:

Existing Thresholds	Proposed new thresholds
1. The undertakings concerned combined worldwide turnover is RMB 10 billion, or combined PRC turnover is > RMB 2 billion; and	1. The combined worldwide turnover of undertaking concerned is <b>RMB 12 billion</b> , or combined PRC turnover is > <b>RMB 4 billion</b> ; and
2. Each of two undertakings concerned has PRC turnover > RMB 400 million	2. Each of two undertaking concerned has PRC turnover > <b>RMB 800 million</b>

The draft regulations propose a new threshold aimed at competitively significant ('killer') acquisitions:

Proposed new hybrid threshold
1. The turnover of one undertaking concerned in the PRC is > RMB 100 billion; and
2. The other party (s) concerned has market value of RMB 800 million; and generated > 1/3 of its turnover in the past financial year in the PRC.

- **"Stop-the-clock" mechanism:** the 180-day period for merger review can be suspended by SAMR when the parties are working on the SAMR's requests for information (RFIs); there are new facts/issues to be looked into, or the parties are in negotiation over proposed remedies/commitments. The introduction of a "stop-the-clock" mechanism emphasizes the importance of undertaking a China merger filing requirement analysis to allow for greater flexibility in terms of the closing date/long stop date, reverse breakup fee and other risk allocation clauses in transactions.
- **Power to pursue below-threshold deals:** the SAMR is now authorized to require parties to notify it of transactions below filing thresholds if it considers the deal may raise competition concerns. Consequently, parties who do not follow SAMR's requirement to notify, might therefore be subject to penalties for failure to notify.
- **Classification of merger filing cases,** according to the sector involved, the size of the parties' business, and any potential competition concerns as a result of the proposed transaction. Cases in important sectors with a bearing on the people's livelihood, e.g., finance, technology and media, would be more strictly scrutinized, but simplified procedure cases, especially those without effect on market competition in China or promoting the innovation and development of strategically emerging technologies, would benefit from a more streamlined and effective procedure.

## 3. Hub-and-spoke violations in the spotlight

China's antitrust legislation was previously silent on hub-and-spoke violations until specific rules emerged in the two recent industry-specific guidelines, for the platform economy<sup>2</sup> and active pharmaceutical ingredients<sup>3</sup> (APIs), which were both published in 2021. However, in practice, indirect coordination through a common agency or third party, e.g., a shared upstream manufacturer/supplier or a trade association, has been investigated and pursued since 2010.

The Amended AML includes a standalone prohibition on a business operator *"organizing other business operators to reach a monopoly agreement or providing substantial assistance for other business operators to reach a monopoly agreement."* The SAMR draft regulations propose that the hub would be held responsible for the conduct as an "organizer" or "substantial contributor" on the grounds of its decisive or leading role in terms of the scope of the spokes and the terms agreed upon among them, the intention

<sup>2</sup> See Article 8 (Hub and Spoke Agreements) of the *Anti-Monopoly Guidelines for the Platform Economy*.

<sup>3</sup> See Article 9 (Hub and Spoke Agreements) of the *Anti-monopoly Guidelines in the Field of Active Pharmaceutical Ingredients*.



to contribute to the indirect information exchange through its actions, and a prominent function in support of the anticompetitive effects of cartel activities.

In addition to hub and spoke infringements, these provisions appear to be directed at cartel facilitators i.e. a party that may not be active in the relevant market but who helps parties who are in the market to give effect to their cartel agreement, such as in the EU *AC Treuhand* case.

#### 4. A more permissive stance on RPM

SAMR and its predecessor agencies have imposed fines totaling CNY 2.5 billion (approx. USD 0.4 billion) for RPM, in more than 30 cases (an average of more than CNY 80 million/USD 12 million per company).

Similar to the EU, there has been a strong presumption that RPM is anticompetitive in China in SAMR's enforcement to date<sup>4</sup>, although the PRC courts have examined anticompetitive effects in RPM cases.

Following the AML Amendments, RPM will still be treated as presumptively unlawful, i.e. SAMR will not need to show anticompetitive effects. However, a defendant will be able to rebut this presumption, by demonstrating on a case by case basis that RPM did not have such effects. The burden of proof will be on defendants.

Considering China's longstanding approach to RPM, how this defense might be successfully invoked remains to be seen. It would likely require strong evidence, and supported by a range of analytical tools and economic models, public policies, and innovation dynamics. Illustrative examples of circumstances where RPM is exempt from the general prohibition include the short term promotion of new products, genuine agency relationships and public procurement<sup>5</sup>.

#### 5. Safe harbours for vertical restraints

Article 18(3) of the amended AML enables SAMR to grant safe harbors for certain vertical restraints, for instance territorial restraints, single branding, non-compete and other exclusive arrangements.

Unlike RPM, non-price vertical restraints are not presumptively anticompetitive under the AML<sup>6</sup>, and SAMR's enforcement efforts to date have focused almost exclusively on RPM<sup>7</sup>. We have seen limited guidance that suggests certain non-price restraints may be problematic in certain sectors, namely absolute territorial restrictions in the context of the distribution of vehicles and related spare parts.<sup>8</sup> The safe harbor provision could offer more clarity in the assessment of vertical restraints under China competition law.

The safe harbors are to be based on a market share threshold and certain conduct-specific tests<sup>9</sup>, which are not specified in the AML Amendments. The SAMR will likely do so in future guidance or decisional practice<sup>10</sup>. The SAMR appears to retain discretion to enforce against conduct falling within a safe harbour, where there is evidence of anticompetitive harm.

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<sup>4</sup> See for example a record USD 118m RPM fine on a pharmaceutical company in 2021 and the stance of the Supreme People's Court set out in ruling (2018) Zui Gao Fa Xing Shen No. 4675.

<sup>5</sup> See Article 6(2) of the *Antitrust Guidelines for the Automotive Industry*.

<sup>6</sup> Article 18 of the amended AML (former Article 14 of the AML), with a catch-all provision, preserves Chinese competition authority's objections to any other forms of vertical restraints, most notably non-price restraints, but such provision has not yet been employed in practice.

<sup>7</sup> The SAMR found in all of the 3 RPM cases since 2021 that among others, RPM could be implemented through strictly prohibiting distributors from selling products outside the allocated territory.

<sup>8</sup> See Article 6(4) of the *Antitrust Guidelines for the Automotive Industry*.

<sup>9</sup> Taking exclusive arrangements as an example, it is possible that the agency may limit the duration of such arrangements, e.g. no more than 5 years, as suggested by Article 10(8) of the *Guidelines for Competition Compliance of Enterprises in Zhejiang Province*.

<sup>10</sup> For example, Article 15 of the draft *Regulations on Prohibiting Monopoly Agreements* suggests a 15% threshold. The antitrust guidelines on the automotive sector and IP rights have already put forward 30% safe harbors for vertical agreements, but it is unclear whether these two guidelines would be renewed to be consistent with the Amended AML.



## 6. Scrutiny of platform operators' use of data, algorithms, technology, capital advantage and platform rule setting

Recent SAMR enforcement and private litigation have focused on alleged abuses of dominance by platform operators, particularly exclusivity obligations precluding counterparties from dealing with competing platforms (aka "choose one from two").<sup>11</sup>

As the platform economy in China evolves, there are some signs that the SAMR's enforcement focus in this area may also be shifting. The AML Amendments suggest SAMR will continue to rein in platform operators' allegedly abusive practices, as well as signal increased enforcement with respect to platform operators' business cooperation, vertical restraints and merger review. This is also consistent with China's policy initiatives calling for a holistic approach to strengthen AML enforcement in the platform economy<sup>12</sup>. In addition, the AML Amendments highlight the challenges posed by data, algorithms, capital advantage, technology and platform rules.

In light of this, SAMR and PRC courts may take interest in or be more willing to intervene in respect of:

- Anticompetitive data/technology cooperation between platform operators<sup>13</sup>;
- Formulation of platform rules and algorithm rules<sup>14</sup>; and
- Data/algorithm/technology-driven M&A transactions creating/enhancing market power<sup>15</sup>.

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## Background

Following the two rounds of draft versions published in **January 2020** and **October 2021** respectively, the Standing Committee of the 13<sup>th</sup> National People's Congress issued the final changes to the AML on 24 June 2022.

Further to the AML Amendments, the SAMR released on 27 June 2022 draft changes to six regulations in support of the amended AML, covering cartels and vertical restraints, abuse of dominance, abuse of IP rights, merger control, merger control thresholds, to administrative monopoly.

### Keywords (Use Title Case)

Antitrust & Competition;

China;

Antitrust & Litigation;

Cartels & Compliance;

Merger Control

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<sup>11</sup> See Annual Report on Anti-Monopoly Law Enforcement in China (2021).

<sup>12</sup> See Article 2(4) of the *Opinions of the National Development and Reform Commission and Relevant Departments on Promoting the Healthy and Sustainable Development of the Platform Economy* (Fa Gai Gao Ji [2021]No. 1872).

<sup>13</sup> The key risk would be e-collusion, e.g. use of data/algorithms to implement cartels, indirect collusion via a common platform, and boycott against data-access by new entrants.

<sup>14</sup> According to Articles 7, 15 and 17 of the *Anti-Monopoly Guidelines for the Platform Economy*, conducts subject to antitrust scrutiny include most favored nation clauses, exclusive arrangement, use of data to impose price discrimination, etc.

<sup>15</sup> The SAMR has considered data concentration and its resulting substantial entry barrier in a gun-jumping case in 2021, and required the parties to unwind their exclusive arrangements.



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