O'Melveny

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O'Melveny's *China Competition & Trade Review* offers periodic updates about important antitrust, competition, and trade developments in China. The *Review* is intended to help companies navigate and anticipate China's rapidly evolving regulatory landscape with practical, on-the-ground insights into the country's competitive conditions and the laws framing them.

This installment offers a brief overview of three important legislative initiatives announced over the course of the past six months. Together these initiatives constitute the most significant policy changes in China competition and antitrust since the introduction of the Anti-Monopoly Law ("AML") in 2008:

- ***Amendments to China's AML and proposed new subordinate antitrust legislation.*** The changes to the AML, which took effect on August 1, 2022, significantly increase penalties for contraventions of the law, introduce for the first time rules allowing for natural persons to be fined for antitrust law violations and clarify powers of the State Administration for Market Regulation ("SAMR") to investigate non-notifiable mergers. In addition to the changes to the AML, the regulator has also published a suite of proposed subordinate legislation.

- ***Draft Judicial Interpretation on Handling Civil Antitrust Actions.*** Issued by the Supreme People's Court on November 18, 2022, for public consultation, the draft judicial interpretation draws on international practice and the Court's experience in antitrust cases over the past decade to address procedural issues, questions relating to market definition, the AML's rules prohibiting monopoly agreements and abuse of dominance, and liability for damages in civil antitrust lawsuits.

- ***Proposed amendments to China's Anti-Unfair Competition Law ("AUCL").*** Published on November 22, 2022, the proposed amendments contemplate additional curbs on unfair practices in the digital economy and envisage the introduction of rules prohibiting the abuse of a "position of relative advantage."

Recent Amendments to the AML

On June 24, 2022, the Standing Committee of the National People's Congress ("NPC"), China's top legislative body, approved a raft of amendments to the AML. The amendments became effective on August 1, 2022, 14 years to the day after the AML first came into force in 2008.

The amendments usher in a number of significant changes, many of which were previewed in a draft published by the NPC in October 2021. In tandem, on June 27, 2022, the SAMR released for public consultation six sets of draft regulations concerning merger reviews, monopoly agreements, abuse of dominance, anti-competitive abuse of administrative powers, and the abuse of intellectual property rights. Key changes made to the AML and proposed in the accompanying draft regulations are set out below.

1. Harsher Penalties

- ***Monopoly Agreements.*** In a radical change, the AML introduces personal liability for monopoly agreements. Further to these changes, the infringing business' legal representatives, the "person-in-charge," or persons directly responsible for the illicit conduct will face fines of up to RMB 1 million (approx. US$150,000) or even RMB 5 million (approx. US$740,000) if the circumstances are particularly serious or the conduct has a particularly serious impact.

  In the case of the infringing undertakings, the general rule remains that a fine of up to 10% of the undertaking's turnover for the year prior to the conduct can be imposed. However, the revised law now adds that where the relevant undertaking does not have any historical turnover it may be subject to a maximum fine of RMB 5 million (approx. US$740,000) regardless. Importantly, though, provision is now made that these levels of fines can be *increased by a factor of five* if the circumstances are particularly serious or the conduct has a particularly serious impact. In effect then, the statutory maximum fine for an undertaking is now 50% of that undertaking's revenue in the prior year.

  For trade associations found to have organized monopoly agreements and for monopoly agreements that have been agreed but not yet implemented, the maximum fine has been raised from RMB 500,000 (approx. US$74,000) to RMB 3 million (approx. US$450,000). Again, this can be raised by a factor of five where the circumstances or the impact is particularly serious.

- ***Failure to File (Gun-Jumping).*** The upper limit of the penalty for failing to file a notifiable merger is now set at 10% of the offender's turnover in the prior year if the concentration has or is likely to have the effect of eliminating or restricting competition—the previous cap was RMB 500,000 (approx. US$74,000). Provision is also made for a fine of up to RMB 5 million (approx. US$740,000) for failing to file a transaction that does not eliminate or restrict competition. In practice, however, it will not always be clear to the parties ahead of time whether their transaction raises a competition concern so it will often be prudent to assume the 10% threshold applies.

  Strikingly, all of these fines are now also subject to the new mechanism which allows fines to be increased by a factor of five where the circumstances or the impact of the conduct is particularly serious.

- ***Obstructing an Investigation.*** Companies and individuals that impede or fail to cooperate with an investigation are now subject to harsher penalties. The upper limit of the fine for obstruction is set at 1% of the infringing undertaking's turnover in the prior year (or RMB 5 million (approx. US$740,000) in the event that there is no turnover figure available). The previous rule was a maximum of RMB 1 million (approx. US$150,000). Natural persons found to have obstructed an investigation can be fined up to RMB 500,000 (approx. US$7,400).

  These various fines are also subject to the new aggravated penalties rule discussed below.

- ***Aggravated Penalties*.** The revised AML allows SAMR to impose a fine that is two to five times the otherwise stipulated maximum for any violation that entails "especially serious circumstances," has an "especially pernicious influence" or "especially serious consequences." As noted above, this mechanism applies to the other fining provisions in the AML such that, in principle, the maximum fine for cartel conduct, an abuse of dominance, gun-jumping or breach of a commitment imposed in a merger review could reach 50% of the offending undertaking's turnover in the prior year. The AML is silent on the specific criteria for assessing whether the circumstances or consequences of conduct are especially serious, leaving SAMR with considerable discretion in assessing whether aggravating circumstances are present and when calculating the fine.

  Going on SAMR's prior practice, the expectation is that turnover in the prior year generally means an undertaking's turnover *in China*—rather than global turnover—but the AML itself is silent on this.

2. Revamped Merger Control

- ***Non-Notifiable Mergers***. While the 2008 *Provisions of the State Council on the Notification Thresholds for Concentrations* ("2008 Notification Thresholds") provided for the investigation of non-notifiable mergers (*i.e.*, mergers where the turnover-based notification thresholds are not exceeded and where the mandatory filing obligation is not triggered), the Chinese antitrust authorities have not exercised this power. Changes are now in the offing, as the revised AML clearly provides that SAMR has the power to investigate mergers which are not subject to a mandatory filing obligation, but which have or may have an anticompetitive effect.

- ***Proposals to Raise Turnover-based Notification Thresholds***. Among the draft regulations released for comment in June 2022 is a proposed revision to the 2008 Notification Thresholds that would raise the turnover thresholds for notifiable transactions ("2022 Proposed Notification Thresholds"). Pursuant to the 2022 Proposed Notification Thresholds, a transaction will be notifiable if, in the prior year, the combined global turnover of all parties to the transaction exceeded RMB 12 billion (approx. US$1.78 billion, up from the current RMB 10 billion (approx. US$1.49 billion)), or their combined turnover in China exceeded RMB 4 billion (approx. US$595 million, up from the current RMB 2 billion (approx. US$297 million)), *and* at least two parties *each* generated more than RMB 800 million in China (approx. US$119 million, up from the current RMB 400 million (approx. US$59 million)).

  If these changes are adopted, the impact would be to lower the number of transactions requiring notification in China.

- ***Killer Acquisitions***. Interestingly, the 2022 Proposed Notification Thresholds include a provision designed to tackle "killer acquisitions," *i.e.*, where an established player acquires a nascent competitor to ward off a future competitive threat. Under the 2022 Proposed Notification Thresholds, an established player is a party to the transaction whose turnover in China in the prior year exceeds RMB 100 billion (approx. US$14.9 billion), while the nascent target must be valued at no less than RMB 800 million (approx. US$119 million) and have generated at least a third of its turnover in the prior year in China. These rules seem unlikely to impact foreign-to-foreign transactions.

- ***Stop the Clock***. The revised AML now authorizes SAMR to suspend its review—*stop the clock*—in three scenarios: 1) where the filing parties fail to submit requested documents; 2) where important

new facts need verification by the SAMR; and 3) where a remedy proposal requires further evaluation by the SAMR and the filing parties have requested a suspension of time. No further guidance is available on when this important new procedural tool might be used, leaving SAMR with broad discretion as to when a suspension is warranted and how long the suspension should last.

It is too early to say how and whether 'stop the clock' will impact the overall SAMR review timeline. In the past, with complex cases, especially those requiring remedies, the filing parties typically have had to withdraw and re-file their notifications to give the SAMR additional time to review their transaction, thus extending SAMR's review well beyond the statutory 180-day period. 'Stop the clock' might be expected eventually to replace the informal 'pull and refile' (although this is not clear as the two can be used in tandem) but it is doubtful that the mechanism will mean a more expedited review overall. The most that might be said at this stage is that 'stop the clock' may provide parties with some additional visibility into the pace of the review.

3. Substantive Prohibitions and Enforcement Focus

- ***Digital Markets and Platform Economies***. The changes to the AML include two new provisions touching on the digital/internet economy: Article 9, a new standalone article that prohibits undertakings from using data, algorithms, technology, capital advantages and platform rules to engage in anticompetitive conduct; and Article 22, which provides that an undertaking with a dominant market position must not use data, algorithms, technologies or platform rules to engage in abusive conduct.

  That the changes to the AML in this area are confined to these two low key amendments signals that SAMR's struggle with the platform economy in recent years has entered a new more mature phase following its 2020 regulatory crackdown on China's internet giants. And these modest changes to the AML find an echo in certain proposed revisions to the *Interim Provisions on the Review of Concentrations of Undertakings* released in June 2022 which envisage requiring merging parties to amend platform rules or algorithms as a form of behavioral remedy in the context of a merger review; and in certain proposed revisions to the draft *Provisions on Prohibiting of Monopoly Agreements* (again released in June of last year) which provide that anticompetitive agreements can entail collusion in respect of algorithms or platform rules.

- ***Safe Harbors for Vertical Agreements***. The revised AML makes provision for a market share-based safe harbor for vertical agreements—there had previously been some consideration of having a broader rule which also covered horizontal arrangements, but this more ambitious approach has not been pursued. Pursuant to the changes, the SAMR may set the relevant market share threshold for the safe harbor, which SAMR has proposed should be 15% in its draft *Provisions on Prohibiting Monopoly Agreements* released for public comment on June 27, 2022.

  Regrettably, the draft *Provisions on Prohibiting Monopoly Agreements* appear to require that an undertaking seeking to take the benefit of the safe harbor must establish that there is no evidence that the relevant conduct has the effect of eliminating or restricting competition. This requirement to prove a negative risks emptying the safe harbor of its practical utility if adopted.

- ***Resale Price Maintenance is Presumptively Illegal***. Resale Price Maintenance ("RPM") has always been presumed illegal by SAMR in the context of its administrative enforcement. By contrast, the

Chinese courts have largely adopted a "rule of reason" approach to RPM in private litigation. The divergent approach has been criticized over the years. The revisions to the AML now endorse SAMR's approach of placing on the parties the burden of proving a lack of harm to competition—failing which the RPM is presumed illegal.

Draft Judicial Interpretation on Handling Civil Antitrust Actions

On November 18, 2022, China's Supreme Court released for public consultation its draft *Provisions on Certain Issues Relating to the Application of the Law in the Trial of Monopoly-Related Civil Disputes* ("Draft Judicial Interpretation").[1] The Draft Judicial Interpretation is a follow-up to a similar judicial interpretation issued in 2012 ("2012 Judicial Interpretation") and draws on the experience that the Chinese courts have accumulated over the past decade as well as international best practice.

The Draft Judicial Interpretation—which runs to some 52 articles—addresses issues concerning procedures, market definition, monopoly agreements, conduct amounting to abuse of dominance and questions of liability in civil antitrust actions. If adopted, the Draft Judicial Interpretation will supersede the 2012 Judicial Interpretation.

Key aspects of the Draft Judicial Interpretation are discussed below.

1. Procedural Issues

- ***Non-Arbitrability of Antitrust Claims***. The Draft Judicial Interpretation confirms that the Chinese courts retain jurisdiction over private antitrust disputes notwithstanding the inclusion of an arbitration clause in the parties' contract. This position reflects the Supreme Court's 2019 ruling in *Shell (China) Limited v. Hohhot Huili Material Co., Ltd* where the Court concluded that the AML requires as a matter of law that either an administrative agency of the State or a court evaluate allegations of anticompetitive conduct, leaving no room for the arbitration of private antitrust disputes. The Court explained that the AML is a public enactment aimed at preventing anticompetitive conduct, ensuring fair competition, and protecting consumers at large. Claims of anticompetitive conduct implicate interests going beyond those of the parties to a private contract. As a result, only a public body, such as a court or competition authority, is competent to take these wider public interests into account when ruling on a competition dispute.

- ***Interplay Between Administrative and Judicial Enforcement***. In the case of "follow-on actions", the Draft Judicial Interpretation provides that where a breach of the AML has been established in a decision taken by an administrative enforcer and the administrative enforcer's decision has not been challenged in court or has been confirmed by the court if so challenged, the plaintiff can rely on the administrative enforcer's finding of an infringement. The plaintiff need only prove causation—that it suffered loss as a result of the infringing conduct. However, if there is sufficient evidence to contradict the administrative enforcer's findings, the plaintiff may not rely on that finding to prove the contravention. This latter *proviso* is somewhat unusual and adds uncertainty as to the extent to which the plaintiff can rely on the prior regulatory finding.

[1] https://www.court.gov.cn/zixun-xiangqing-380101.html

The Draft Judicial Interpretation further specifies that the court may suspend its proceedings pending the conclusion of an administrative enforcement action if the alleged conduct is concurrently under investigation by an administrative enforcer. The court may also refer conduct which may breach the AML to an administrative enforcer for investigation.

2. Market Definition

The Draft Judicial Interpretation provides for a few exceptions to the general rule that the plaintiff bears the burden of defining the relevant market within which the effects of the defendant's alleged actions occur. In this regard, the plaintiff is not required to define the relevant market if he can otherwise directly establish that the defendant has "significant market power" in a case involving a monopoly agreement, has a dominant market position in an abuse of dominance case or that the conduct has the effect of excluding or limiting competition.

The Draft Judicial Interpretation further explains that the plaintiff does not need to define the relevant market where the defendant's conduct amounts to hardcore cartel conduct (*i.e.*, involving price fixing, an output restraint, market division, restraints on innovation and/or a joint boycott) or resale price maintenance ("RPM").

3. Monopoly Agreements

- ***RPM vs. Non-Price Vertical Restraints: A Bifurcated Approach***. The recent amendments to the AML establish a rebuttable presumption of illegality in the case of RPM. This means that the plaintiff does not need to show that RPM harms competition. Rather, the burden is on the defendant to rebut the presumption of illegality by demonstrating that the RPM is not anti-competitive. Unsurprisingly, the Draft Judicial Interpretation endorses this approach, but also specifies that if the defendant demonstrates that it falls within the market share-based safe harbor established by the administrative enforcer, the plaintiff then needs to show that the RPM is anti-competitive. SAMR's current proposal is to set a market share cap of 15% for the safe harbor.

  In contrast to the approach for dealing with RPM, the Draft Judicial Interpretation places the burden on the plaintiff of proving harm to competition in cases involving non-price vertical restraints (such as territorial restrictions, customer restrictions *etc.*). This reflects the general consensus that non-price restraints should not be presumed illegal and that a "rule of reason" standard should be applied to assess such arrangements.

- ***Assessing Vertical Restraints***. The Draft Judicial Interpretation recognizes that "significant market power" is a necessary although not sufficient condition for vertical restraints to be harmful and mandates a finding of illegality if the defendant has such power and the anti-competitive effects of the conduct outweigh its pro-competitive effects. The Supreme Court does not define "significant market power" in the Draft Judicial Interpretation (an economic concept frequently equated with dominance), but enumerates a number factors to be considered when balancing the anti-competitive and the pro-competitive effects of conduct. Those factors include, on the one hand, whether the vertical restraint raises barriers to entry, obstructs more efficient distribution models or forecloses distributors, or restricts intra-brand competition, *etc*. and on the other hand, whether the vertical restraint serves to prevent free-riding, promotes inter-brand or intra-brand competition, protects brand image, raises service levels, or promotes innovation.

The Supreme Court further notes that in certain scenarios, vertical constraints may not be illegal. Such scenarios include where the defendant's market share falls within the safe harbor set by SAMR (i.e., currently envisaged as 15%), or where the vertical restraint is implemented for a limited but reasonable period time and for the purpose of encouraging a trading partner to promote a new product. In addition, the Supreme Court confirms that vertical constraints imposed by a principal on its genuine agent fall outside of the AML. These various pronouncements are consistent with international practice.

4. Abuse of Dominance

- ***Dominance***. To assist courts with the identification of dominance, the Draft Judicial Interpretation proposes that they may make a *prime facia* finding of dominance, if (1) there is evidence that the defendant has maintained prices substantially above the competitive level for a sustained period of time or a market share substantially higher than those of other players in the market for a sustained period of time; and (2) there is other evidence of an absence of competition, innovation and/or new entrants in the relevant market.

- ***Collective Dominance***. The AML provides that firms may violate the law by abusing a position of "collective dominance." In this regard, the AML imposes a rebuttable presumption that firms are collectively dominant if two firms have a combined market share of 66.6 percent or more, or three companies have a combined market share of 75 percent or more. The Supreme Court proposes in the Draft Judicial Interpretation that the presumption of "collective dominance" can be rebutted if there is evidence of substantial competition between the firms presumed to be collectively dominant or if these firms as a group face effective competitive constraints imposed by other firms.

- ***Abusive Conduct***. The Draft Judicial Interpretation also offers some practical guidance on the different types of abusive conduct prohibited by the AML.

    - *Unfairly High or Low Pricing:* The Draft Judicial Interpretation provides that the courts may find a breach of the AML if there is evidence that (1) a dominant firm has sold or purchased products at prices that are above or below (as applicable) the prices at which it sells or purchases the same or comparable products in the market and (2) its pricing substantially squeezes equally efficient trading partners' profit margins such that they cannot compete effectively in the market.

    - *Selling Below Cost:* According to the Draft Judicial Interpretation, selling below cost by a dominant firm may breach the AML, if (1) the dominant firm sells a product below its average variable cost or average avoidable cost for a significant period of time or (2) if the dominant firm sells its products above the average variable cost or average avoidable cost but below average total costs for a significant period of time and there is evidence of a clear intention to exclude or restrict other equally efficient firms from competing. These proposals are generally in line with international practice.

    - *Exclusive Dealing, Tying, Bundling and Discrimination:* As regards exclusive dealing, tying and bundling, and discriminatory treatment, the Draft Judicial Interpretation specify that anti-competitive effects are a necessary condition for the conduct to be abusive. The Draft Judicial Interpretation further enumerates factors to be considered in assessing

these effects. For example, for exclusive dealing, the courts may consider the duration of the conduct and the portion of the market impacted, whether the alleged conduct raises barriers to market entry, rival's costs or results in market foreclosure, *etc*. For discriminatory treatment, the courts may consider whether the alleged conduct increases total output or the number of users, whether the alleged conduct restricts a trading partner from competing with rivals, *etc*. The Draft Judicial Interpretation further clarifies that preferential treatment afforded to a particular user for a reasonable period may be justifiable and not discriminatory *vis-à-vis* other users.

5. Remedies

In addition to injunctions and damages available to the plaintiff in a private action, the Draft Judicial Interpretation contemplates a court ordering the defendant to take particular positive action to restore competition to the market.

The Draft Judicial Interpretation also confirms that the party suffering harm as a result of the anticompetitive conduct of another is entitled to compensation not only for direct loss but also for any loss of profit, while the defendant is entitled to a "pass-on" defense (*i.e*., the defendant may argue that damages should be reduced to the extent that plaintiff's customers have absorbed the loss).

Proposed Amendments to the Anti-Unfair Competition Law

On November 22, 2022, SAMR released draft amendments to China's Anti-Unfair Competition Law (the "AUCL") for consultation.[2] In contrast with the AML, which prohibits conduct that harms competition, the AUCL is concerned with trade practices in violation of the principle of good faith and/or which involve deceptive or fraudulent business practices, such as trade mark infringements, commercial bribery, false and misleading advertising, trade libel, *etc*.

The AUCL, first adopted in 1993, underwent two rounds of amendment in 2017 and 2019. According to an explanatory note from SAMR accompanying the current proposed amendments (the "Draft Amendments")[3], this third round of proposed changes seeks to address a perceived need to rein in new types of unfair businesses practices involving the use of data, algorithms, and platform rules in the digital sector. In addition, the Draft Amendments introduce rules prohibiting the abuse of a "position of relative advantage" and envisage new stiffer penalties for contraventions of the AUCL.

1. Unfair Trade Practices in the Digital Economy

The Draft Amendments propose a general prohibition on using "data and algorithms, technology, capital advantages, and platform rules to engage in unfair competition." The current version of the AUCL already prohibits 'traffic hijacking' (where a firm redirects a user to its own website or services while the user is browsing another firm's website) and 'malicious incompatibility' (where a firm uses technical means to hinder compatibility with the online products or services of another firm) in the internet sector. The Draft Amendments expand the list of prohibited practices to prohibit a platform from improperly restricting

[2] https://www.samr.gov.cn/hd/zjdc/202211/t20221121_351812.html

[3] https://www.samr.gov.cn/hd/zjdc/202211/t20221121_351812.html

access to merchants, from improperly acquiring or using non-public data legitimately collected by another firm in order to compete with that firm or engaging in differential treatment using algorithms to analyze users' preferences and trading habits, *etc*.

The Draft Amendments also propose a framework for the assessment of unfair competition practices in the digital sector. In this regard, SAMR and its regional offices are required to assess how investigated conduct may impact the interests of consumers, other firms and the public interest, technical innovation, the network ecosystem, whether coercive or fraudulent means have been employed and whether the conduct is contrary to industry practice, business ethics, or fair, reasonable and non-discriminatory ("FRAND") principles. The Draft Amendments therefore impose a FRAND obligation and the various other obligations listed on firms in the digital sector, whether or not they might be dominant under the AML.

2. Abuse of a Position of Relative Advantage

The Draft Amendments introduce new rules concerning unfair trade practices by firms with a "position of relative advantage." Where a firm enjoys advantages in terms of technology, capital, the number of users, industry influence, *etc*., or if other firms rely on it in transactions, that firm may be considered to have a position of relative advantage. The Draft Amendments ban such a firm from imposing unreasonable terms or restrictions on trade counterparties, including exclusive dealing arrangements, coercive tying, restrictions on price, promotional activities, sales territories, *etc*., the withholding of deposits, subsidies, discounts or restricting network traffic, and interference with transactions by way of influencing user choices, blocking or downgrading search results and/or the removal of hits from search results.

Similar rules controlling abuses of a superior bargaining position exist in Germany, France, Japan, Korea, Taiwan and other jurisdictions. These rules prohibit firms from exploiting their bargaining power in relationships with trading partners so as to extract concessions considered unfair. A recent trend globally is the use of these rules to address concerns in the digital sector involving platform operators. Often the rules are seen as a way of circumventing the challenges of using competition law from the regulatory perspective where the more formalist or legal concept of a superior bargaining position is considered less burdensome relative to establishing market dominance as an economic matter.

3. Harsher Penalties

Finally, it should be noted that the Draft Amendments envisage stiff penalties for unfair trade practices in the digital sector and for abuses of a position of relative advantage, including disgorgement of profits and a fine of up to RMB 1 million (approx. US$150,000). In "serious circumstances", the maximum fine is raised to RMB 5 million (approx. US$740,000).

The Draft Amendments also provide for further aggravated penalties where there are "especially serious circumstances" or the conduct is "especially pernicious" resulting in "serious harm" to the competitive order or the public interest—similar to the mechanism recently added to the AML. These aggravated penalties include fines ranging from 1% to 5% of annual revenues, and the suspension or revocation of business licenses, and/or the infringing businesses' legal representatives, persons-in-charge, or persons directly responsible for the impugned conduct being subject to fines ranging from RMB 100,000 to RMB 1 million yuan (approx. US$ US$15,000 to approx. US$150,000).

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