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In line with global developments, China's antitrust authority, the State Administration for Market Regulation ("**SAMR**"), has taken a series of actions in the digital space in 2021, signalling tightened scrutiny of tech companies in China. Developments in both the legislative and regulatory fronts have been observed. In parallel to vigorous enforcement actions, the Chinese government revamped the regulatory regime over the digital economy. Steps taken include, amongst other things, the publication of the digital antitrust guidelines and proposed amendments to the Chinese Anti-Monopoly Law ("**AML**"). The Chinese government does not intend to crack down on any single business but instead ensures that China's digital economy remains competitive and innovative. Such efforts reflect a paradigm shift in which the Chinese authorities no longer hold a tolerant, laissez-faire attitude toward the fiercely-expanding platform economy.

Against this background, foreign enterprises – including both digital companies and foreign investors – have become increasingly anxious about China's antitrust enforcement in the digital sector. As a result, businesses are keen to understand the implications brought by China's antitrust enforcement in the digital sector. This article discusses the implications from merger control and behavioral aspects perspectives. We will also offer suggestions on how companies should plan for their activities or investment in China's digital sector and formulate the right strategies to navigate through China's enforcement regime in the digital sector.

I. Revamping the Antitrust Regulatory Regime for the Digital Sector

Since late 2020, the Chinese government has sought to revamp the antitrust regulatory framework by taking into account the unique features of the digital economy, e.g., the multi-sided nature of platform operators, network effects, digital companies' possession and use of technology, big data, etc. Sectoral antitrust guidelines and revision to the AML reflect China's determination to develop more sophisticated frameworks of assessment that have traditionally not featured in China's antitrust regime.

A. Publication of the Antitrust Guidelines for the Platform Economy

On November 10, 2020, SAMR introduced sweeping draft rules designed to regulate the digital economy by publishing the draft Antitrust Guidelines for the Platform Economy (the "**Digital Guidelines**", signalling the start of China's antitrust scrutiny and enforcement against the digital sector. These guidelines were promulgated in February 2021. Amongst other things, the Digital Guidelines outlined distinctive features of digital platforms that should be taken into account in defining the market and assessing dominance, highlighted that certain uses of big data and algorithms may breach the AML, and importantly, confirmed the notifiability of transactions involving the variable interest entity ("**VIE**") structure and that "below-threshold" transactions may also be subject to merger review.

B. Proposed Amendments to the AML

Proposed amendments to the AML published in October 2021 reflect that the Chinese government has considered the digital economy in amending the AML. For example, a new article was included to oblige businesses not to restrict competition by abusing the advantages in data and algorithms, technology and capital and platform rules. In assessing the abuse of dominance, factors such as possession of data and technologies, the use of algorithms, etc., were listed as relevant factors.

C. Other Legislations

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Beyond the antitrust framework, China is also gradually establishing a comprehensive regulatory system in the digital sector. A more stringent regulatory system will further promote efficient, accurate and comprehensive enforcement by the authorities.

Laws/Regulations (Year of Enforcement)	**Main Content**
The Anti-Unfair Competition Law ("AUCL") (1993)	The AUCL contains provisions that regulate actions that amount to unfair competition by internet companies.
Data Security Law (2021)	The Data Security Law prohibits using data to restrict or eliminate competition.
E-commerce Law (2019)	The E-commerce Law imposes special obligations on e-commerce platform operators. In line with the AML, it sets out that dominant platforms must not abuse their dominant position to exclude or restrict competition.
Measures for the Supervision and Administration of Online Trading (2021)	The Measures stipulate that operators of online trading platforms shall not interfere with the independent operation of operators within its platform; otherwise, it may constitute anticompetitive behavior.
Provisions on Prohibited Acts of Unfair Online Competition (Draft for the Consultation) (2021)	The provisions summarize common behaviors of unfair competition in the digital sector and the relevant judicial and enforcement experience. The provisions highlight the types of unfair competition enabled by new technologies, such as the use of technology that refuses to deal with or enforce exclusivity obligations, big data/algorithms to target consumers, etc.

II. Merger Control

In conjunction with the regulatory overhaul, SAMR has significantly intensified its review of transactions involving the digital sector, illustrating that it is building an increasingly sophisticated framework for merger review in the digital age. Crucially, the authority has also sought to clarify various unsettled issues, including the implication of structures in merger review and China's approach in regulating killer acquisitions.

A. Ramped-up Enforcement Actions Against Failures to Notify Focusing on the Digital Sector

Digital sector-related cases account for the vast majority of failure-to-notify cases, manifesting SAMR's determination to address historical failures to notify in the internet industry. From 2014 (when the Chinese antitrust authority started enforcing against failure to notify) to the end of November 2021, SAMR published 155 failure-to-notify penalty decisions. In 2021 alone, SAMR published 107 failure-to-notify penalty decisions, the highest number per year since the enforcement of China's antitrust regime. Of these 107 cases, 98 (92%) involved at least one digital company.

The large number of cases involving internet companies was primarily driven by the fact that Chinese digital companies rarely (if ever) made notifications to SAMR due to their adoption of the VIE structure to manage foreign investment regulatory issues. The legality of VIE structures has long been debated in China. Historically, if a transaction party has a VIE structure, there would usually be difficulties notifying the transaction under China's merger control regime, because the transaction party are not able represent to the China antitrust authority that they are in full compliance with the Chinese laws. The difficulty also applies to the antitrust authority when they seek to penalize companies with VIE structures for failure to notify, because they are not able to address the legality of the VIE structure. However, the legality of the VIE structure does not really fall into the review scope of a merger control filing. Therefore, the SAMR has made many efforts and eventually managed to de-link the VIE legality issue from merger control review regime in 2020. Following the publication of the draft Digital Guidelines in November 2020, SAMR issued three failure-to-notify penalty decisions against tech companies Alibaba, China Literature (ultimately controlled by Tencent) and Hive Box in December 2020. While not mentioned by SAMR in the penalty decisions, all of these businesses are reportedly structured as VIEs.

Out of the 98 cases of failures to notify involving the digital sector, 25 involve one or more investors acquiring joint control of the target company together with an internet company. This results in SAMR imposing penalties on all the parties acquiring control in the same transaction, as each has a duty to notify SAMR. In addition, many multinational companies have been implicated in such cases. For example:

- Mitsubishi Heavy Industries was given a fine of CNY 500,000, alongside Suning.com, for setting up a jointly controlled joint venture in 2011 without prior notification;
- Toyota received a fine of CNY 500,000 for setting up a jointly controlled joint venture with Didi, the biggest ride-hailing service company in the world in 2019 without prior notification;
- Softbank has been imposed a fine of CNY 500,000 for setting up a jointly controlled joint venture with Didi in 2018 without prior notification;

Therefore, foreign companies must be aware of SAMR's scrutiny in the digital sector. Foreign investors need to carefully assess whether the transaction gives rise to merger filing obligations in China to avoid potential investigation and penalties when investing with Chinese internet companies. Also, the penalties for failure to notify are significantly increased under the AML Amendments, from RMB 500,000 (approximately USD 78,350) in the current law to a minimum of RMB 5 million (approximately USD 784,000) as proposed in the AML Amendments if the transaction does not have any anti-competitive effects. If the transaction is found to have an anti-competitive effect, the penalties will be even higher, up to 10% of a company's turnover.

B. Intensified substantive review of merger cases involving the digital sector. Investments in China's digital sector is no longer risk-free from a merger control perspective.

Tightened scrutiny over the digital sector in merger review is not only reflected in the significant increase in the number of failures to notify. A more substantive assessment of the anticompetitive effect was carried out in a merger review by SAMR in digital sector-related cases. This is evident in SAMR's decision to block the proposed merger between DouYu International Holdings Limited ("**Douyu**") and HUYA Inc. ("**Huya**").

On July 10, 2021, SAMR announced its decision to prohibit the proposed merger between Douyu and Huya.[2] While it is the third time China's competition authority has blocked a transaction since the implementation of the AML, this is the first prohibition decision involving digital companies. Huya and DouYu are two leading game live-streaming platforms in China, with a combined market share of at least 60 percent in the domestic game live streaming market. Before the transaction, Huya was already solely controlled by Tencent; and Tencent and DouYu's founder team jointly controlled Douyu.

[2] https://www.samr.gov.cn/xw/zj/202107/t20210710_332525.html.

After the proposed merger, Tencent would acquire sole control over Douyu.

Notwithstanding the fact that the transaction only involves a change in nature of control (joint to sole) which typically would not raise competition issues, SAMR raised horizontal and vertical concerns. Specifically:

- Horizontal concern: SAMR concluded the proposed merger would reinforce the dominant market position of Tencent in China's game live streaming market, given the combined shares of Douyu and Huya are at least 60%, high entry barrier attributed to copyright licenses, financial investment and game streamer resources required.
- Vertical concerns: (1) input foreclosure – SAMR opined that Tencent had the ability and incentive to foreclose competitors in the downstream game live streaming market by denying access to the online game copyright license owned by Tencent in the upstream market of online game operation services, where it has an over 40% market share; (2) customer foreclosure – SAMR considered Tencent to have the ability and incentive to foreclose competitors in the upstream market of online game operation services through blocking the access to the promotion channel available on the game live streaming platform controlled by Tencent.

In an unprecedented move, on July 24, 2021, SAMR published its penalty decision on the Tencent/China Music Group merger: the first failure-to-notify case in China in which remedies were imposed since the implementation of the AML. The Tencent/China Music Group merger (closed in 2017 without notification to SAMR) created a dominant player, Tencent Music Entertainment Group (Tencent Music), in China's online music streaming platform market. Tencent Music owned more than 80 percent of exclusive music library resources. SAMR ordered Tencent Music to abandon its exclusive music copyright licensing arrangement.[3] The case demonstrates that SAMR will continue to consider exclusivity agreements as an antitrust enforcement priority. Tencent was also required to notify SAMR of future transactions, including those that fall below notification thresholds - a requirement that generally goes beyond the scope of remedies contemplated under the AML.

<u>Towards the future: the regulation of killer acquisition</u>

China's attempt to strengthen the so-called "killer acquisition" regulation is also noteworthy. "Killer acquisitions" refer to the transaction where a larger company acquires a small player to stifle future competition. In the digital sector, as companies try to attract consumers by charging very low or even nil prices in their early stages of development, many target companies are not profitable, resulting in low acquisition costs. Thus, such killer acquisitions occur more frequently in the digital space than in other sectors.

Killer acquisitions have become a hot topic globally. They have attracted the attention of many merger control regimes.[4] In most jurisdictions (like China), the thresholds of merger control are generally based on the turnover of the acquirer and the target. Given that the target companies generate little revenue, merger control regimes need to find innovative ways to capture such transactions.

In China, turnover thresholds to trigger a filing in China were set in 2008 when the Chinese antitrust regime was introduced. To date, the thresholds have remained unchanged. Although the thresholds were questioned by some as too low to accurately reflect the economic growth in China in the last decade, the thresholds still failed to catch certain high-profile transactions, especially those in the digital sectors, such as the merger between ride-hailing platforms Didi and Uber in 2015.

Since 2018, a "below-threshold" review mechanism has been provided under the existing legal merger review framework[5], which

[3] https://www.samr.gov.cn/xw/zj/202107/t20210724_333016.html.

[4] As can be seen in the Annex to the Summary Record of the 133rd Meeting of the Competition Committee held on 10-16 June 2020, which thoroughly discusses the theory of harm and the empirical evidence, https://one.oecd.org/document/DAF/COMP/M(2020)1/ANN4/FINAL/en/pdf.

[5] Stipulated in the Provisions of the State Council on the Standard for Declaration of Concentration of Business Operators, see: https://gkml.samr.gov.cn/nsjg/fldj/202005/t20200526_315561.html.

enables the antitrust authority to initiate an investigation of a transaction that falls below the notification thresholds provided that there is evidence that the transaction has or may have the effect of eliminating or restricting competition. In 2021, the Digital Guidelines and the proposed AML amendments once again highlight the “below-threshold” review. Specifically, the Digital Guidelines stipulate the type of mergers in the digital sector that may warrant SAMR’s scrutiny, such as situations where a party is a start-up/has limited turnover due to adoption of a free or low price business model or that the relevant market being concentrated, etc. The position was confirmed in the proposed AML amendments. The “below-threshold” review mechanism will likely create uncertainties in transactions that fall under the notification thresholds and may have far-reaching consequences to investors wishing to acquire Chinese start-ups.

Evidently, Transactions in the digital sector are under scrutiny. Substantive competitive assessment is advisable in the deal planning stage to avoid surprises during SAMR's merger review process. In addition to antitrust scrutiny, in recent months, it has been observed that where a digital platform is involved, SAMR would also consult China's data regulator, the Cyberspace Administration of China ("**CAC**"), as the relevant industry authority. It is a standard practice for the SAMR to consult with relevant industry authority in charge of the underlying industry involved in the transaction under review. As the CAC is the authority in charge of the internet industry, they should indeed be consulted if the underlying industry involved in the transaction is internet related. However, as the investment of the digital platform can be quite diversified. It is uncertain if an investment by digital platform into industries unrelated to internet industry should still require consultation with the CAC.

III. Behavioral Enforcement

Behavioral enforcement actions have also intensified against digital companies. In 2021, SAMR published landmark decisions against domestic tech giants, Alibaba and Meituan, for exclusivity arrangements. In the future, more complex and novel abuses may be investigated, such as a platform’s limitation of interoperability of other platforms, most particularly exemplified through link-blocking**.**

A. Enforcement Actions Regarding Exclusivity Arrangements

In terms of enforcement focus in the digital sector, exclusivity arrangements - mostly presented as “either-or” obligations in China – have drawn particular attention. These obligations require in-platform vendors to only sell on one platform or only join a promotional program organized by one platform at a given time of promotion. This could be achieved through contractual terms, verbal instructions, and/or rewards/penalties to prevent vendors from collaborating with competing platforms.

Prior to 2021, these cases have only been enforced under the Anti-Unfair Competition Law – the maximum penalty of which would be RMB 3 million (approx. **USD 470,000).** Since late 2020, “either-or” restrictions have become the highlights of SAMR’s enforcement activities against the platform economy. In 2021, SAMR investigated multiple cases regarding exclusivity arrangements in the digital sector, including the penalty decisions against Alibaba, Sherpa’s and Meituan. All of these three companies were found to have abused their dominance by imposing “either-or” clauses on in-platform vendors.

Case	Decision Date	Duration of Investigation	Fines (RMB) / Fining percentage	Market Definition	Conduct being identified as an abuse of dominance
Alibaba	April 10, 2021	5 months	18.2 billion (approx. USD 2.86 billion)/4% of Alibaba's sales in China in 2019	the market for online retail platform services (China)	• Verbal and written prohibition on certain in-platform vendors to open stores and join promotional activities on rival platforms • Using various incentives and punitive measures to ensure the implementation of the "either-or" requirements
Sherpa's	April 12, 2021	16 months	1.2 million/3% of Sherpa's sales in 2018	English-language online food delivery platform service (Shanghai city)	• Signing cooperation pacts with in-platform vendors with exclusive dealing requirements • Enforcing the exclusive dealing requirements • Formulating and carrying out a detailed exclusive dealing plan.
Meituan	October 8, 2021	6 months	3.4 billion (approx. USD 534 million, 3% of its 2020 China revenue) and a full refund of the exclusive cooperation deposit of 1.3 billion to in-platform merchants (approx. USD 204 million)	the market for online food delivery platform services (China)	• Pushing in-platform vendors to sign agreements with Meituan with exclusive dealing requirements • Enforcing the exclusive dealing requirements • Using various measures to ensure the implementation of the requirements such as using "big data" supervisory tools, and collecting "deposit fees".

Some key lessons can be learnt from the decisions above:

1. **Not only "big techs" are subject to scrutiny.** The Alibaba and Meituan decisions show that SAMR paid close attention to "big techs", but smaller platforms should not assume that they are unregulated. In Sherpa's, the relevant market was defined as Shanghai's English-language online food delivery platform service. Therefore, it may come as a

surprise that Sherpa's - a relatively small company with annual revenue of only CNY 38m (USD 6m) in 2018, was liable for "abuse of dominance" as it has close to 100% share in the niche market. While only domestic businesses have been caught thus far, foreign enterprises should also be mindful that their Chinese operations/subsidiaries may also be subject to scrutiny.

2. **The possession of data and the use of advanced algorithms play an important role in SAMR's** analysis of **dominance** For example, when analyzing Meituan's market position, SAMR considered Meituan's accumulation of the enormous amount of transaction, payment, and user review data, which enabled the building up its own data-based efficient distribution arrangement and dispatch system precise profiling of users. Similarly, SAMR highlighted various factors determining Alibaba's market power in the Alibaba case. These include Alibaba's possession of abundant data, which equips it with the ability to personalize its application to better meet customers' demands and accurately monitor the operations of the in-platform vendors' activities on its competing platform, capabilities in cloud computing and big data analysis.

3. **Exclusivity arrangements are risky for dominant platforms.** The three decisions clearly establish SAMR's rationale in finding exclusivity arrangements imposed by dominant platforms give rise to lead to anticompetitive effect, and it may be difficult for future defendants to argue otherwise. The table below summarizes the factors considered in assessing the impact of the exclusivity restriction in the three penalty decisions and relevant litigations.

Assessment	Factors considered in the assessment
Assessment of impact on the relevant market	<u>Foreclosure of competitors</u> • Competing platforms' decline in the sales of products that are affected by the exclusivity restrictions and slowdown in sales growth; • Competing platforms' slowdown in upgrading and development; • Decrease in the number of users on competing platforms; • The decline in competing platform's market share; • The decline in competing platform's order volume; • The decline in the number of in-platform vendors on competing platforms <u>Impact on market entry</u> • Prolonging new entrants' time of the entry into the market; • Decreasing the number of users accumulated by new entrants within a short period (as measured by the number of daily users, number of active users, number of activated users, monthly independent login users); • Decreasing total downloads of new entrants' APPs; • Decreasing the user growth rate of new entrants compared with the same period when there is no exclusitity requirement.
Assessment of impact on in-platform vendors	• Damage to the business autonomy and right of choice of in-platform vendors • Damage to the legitimate interests of in-platform vendors

	• Weakening of intra-brand competition and inter-brand competition of in-platform vendors • Increase in the commission rate of in-platform vendors
Assessment of impact on consumers	• Restrictions on the free choice of consumers; • Restrictions on consumers' right to fair dealing; and • Rising fees for consumers.

Notably, the implications of network effects have been given additional weight in assessing anticompetitive effects in all three decisions. That is, the increase in the number of users on one side of the platform will strengthen the platform's attractiveness to users on the other side(s). Using e-commerce platforms as an example, the reduction of merchants on the platform will likely reduce the number of consumers on the platform (and vice versa). Considering the strong impact of the network effect, authorities may be particularly skeptical of "either-or" exclusivity obligations as these clauses can, amongst other things, foreclose new entrants and prevent the expansion of competing platforms.

4. **The thresholds to establish justifications were high.** Justifications raised by the enforcement targets were found by the authorities to be untenable from a factual perspective and rebutted by the authorities, as summarized in the table below.

Justifiable causes proposed by the platform	**Rebuttal by the authorities**
In-platform vendors entered into the exclusive cooperation agreements voluntarily	Online vendors prefer operating on multiple platforms at the same time; Penalty measures against non-compliance also show that the signing of the concerned exclusivity agreements was not a voluntary act on the part of the vendors In-platform operators had no choice as the platform used its dominant market position to ask them to do so and treated them unfavorably or imposed punitive measures against those who did not comply
Exclusivity is necessary to protect the platform's particular investments	The investments are for the platform's own operations and not particularly made for any specific in-platform vendor. And the exclusivity is not the only way to protect the investment.
The conduct is a legitimate business practice in response to market competition	The conduct had eliminated and restricted relevant market competition, which damaged the fair competition market order

The decisions suggest that SAMR adopts a very high evidential threshold in accepting the justifications raised by the investigation targets. For example, in the Alibaba case, SAMR rejected Alibaba's justification that in-platform vendors voluntarily enter into exclusivity clauses to obtain certain resources from Alibaba. In doing so, SAMR took into account factual evidence such as that most of in-platform vendors were not given a choice to opt-out from the "either-or" clause and exclusivity arrangements are not necessary for Alibaba to provide resources to in-platform vendors given that Alibaba would invest such resources in the ordinary course of its business to develop its platform in any event.

B. The Future of Behavioral Enforcements: Ensuring Interoperability Between Digital Platforms?

In recent years, the practice of certain tech giants in China restricting content sharing from its rivals on their self-developed Apps has come under significant attention in China. For example, WeChat, the most popular instant messaging app in China, has allegedly restricted users from sharing certain non-Tencent Apps via WeChat by limiting the interoperability of such non-Tencent Apps with WeChat.

Given China's antitrust authorities have not yet concluded any enforcement cases involving the limitation of interoperability, it is not clear how (and if) such practices would be regulated under the AML regime. However, from a legal perspective, conduct that restricts interoperability, such as "link blocking," can be regulated under an abuse of dominance, as shown in the table below.

Potential violation of abuse of dominance	**Most relevant practices**
Exclusive dealing	Restrict users' choice to use the services of third-party APP by blocking access by third-party APP, and induce users to use the products and services within the platform eco-system
Refusal to deal	Refuse to grant API access to third-party APP and thereby refuse connectivity with third party APP
Discriminatory treatment	Different treatment to counterparties under similar conditions, by giving preferential treatment to its own products and services but banning competitors' products
Imposing unreasonable terms	Restrict users from receiving shared content from a third-party platform, or impose redundant, unreasonable, and unnecessary steps for users to access third-party links

Despite the lack of enforcement actions against link blocking practice, private litigations against link blocking are booming in China. The headline case is ByteDance's action against Tencent's link blocking filed in Beijing Intellectual Property Court, claiming RMB 90 million ($13.94 million) in compensation. The claim was based on abuse of dominance.

Outside of the antitrust law regime, link blocking practices have also been reviewed by other industry regulators in China. As Zhao Zhiguo, spokesperson of the Ministry of Industry and Information Technology ("**MIIT**", China's information technology regulator), pointed out, restricting normal access to internet links without proper reason "affects the user experience, damages the rights of users and disrupts market order."[6] On September 9 2021, the MIIT held an administrative guidance meeting to tackle the internet platforms' link-

[6] https://asia.nikkei.com/Business/China-tech/China-tells-Tencent-Alibaba-and-peers-to-stop-blocking-each-other-s-links.

blocking activities. Attendees include Alibaba, Tencent, ByteDance, Baidu, and Huawei. MIIT proposed standards for instant messaging services, requesting the removal of link-blocking by September 17, 2021, or facing penalties.[7] Tencent has now allowed its users to access some of the external links from Alibaba and ByteDance. It is understood that MIIT is targeting anticompetitive practices and unfair competition in the telecom and internet industries in a bid to maintain fair competition for smaller businesses.[8]

Concluding remarks

China's legislative and enforcement efforts since late 2020 illustrate its determined approach to regulating the digital economy. Going forward, we expect the Chinese antitrust authority to continue examining the digital economy. While businesses may have already addressed historical non-compliances such as failures to notify and exclusivity arrangements, it remains possible that SAMR would navigate into more novel areas, such as "killer acquisitions" and limitation of interoperability. We also expect the regulators to further explore critical issues in the development of the digital economy, such as big data, multi-sided markets, and network effects. To adapt to the regulatory sea change, domestic and foreign enterprises active in the digital sector, as well as those who partner with/invest in digital companies, may wish to identify and address antitrust risks highlighted by the recent legislative changes and enforcement actions.

[7] http://www.ce.cn/cysc/tech/gd2012/202109/13/t20210913_36908218.shtml.
[8] https://news.cgtn.com/news/2021-10-17/Minister-MIIT-takes-action-on-monopoly-unfair-competition--14re0hEwVnG/index.html.