

A REFLECTION ON CHINA'S AML ENFORCEMENT RE CONCENTRATIONS OF UNDERTAKINGS IN THE INTERNET INDUSTRY



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China's application of competition law in the digital economy in the past three years has attracted attention worldwide. One significant reason is because of the regulation of VIE-structured transactions. For more than 10 years after the implementation of the Anti-Monopoly Law ("AML"), seldom VIE-structured transactions have been reviewed by the competition authority, which means, almost the whole internet industry hasn't made notifications of concentrations and there were no investigations for a decade. The whole thing has been turned around by end of 2020, when the State Administration of Market Regulation ("SAMR") released the Guidelines for Anti-monopoly in the Field of Platform Economy (Draft for Solicitation of Comments)² in November and specifically stated that VIE-structured transactions should be notified with SAMR if the thresholds are satisfied³. Ever since then, SAMR has officially kicked off the review of the concentration of Internet undertakings, many historical transaction issues have surfaced, and new investments have been imposed with the notification obligation. This article attempts to summarize the characteristics of anti-monopoly law enforcement concerning Internet industry operators in China by reviewing the law enforcement in the past three years and conduct a summary analysis of some of the problems.

China's merger control enforcement under AML in the internet industry faces a lot of challenges. The most obvious obstacle may be the number of historical transactions that need to be dealt with in this sector besides the legal uncertainty of VIE structure. However, the investigation of the historical deals has to some extent helped agencies accumulate experiences with new deals. With the reflection on this topic, more lights could be shed on how to appropriately set "traffic lights"⁴ for investments in the future.

I. THE INVESTIGATIONS OF HISTORICAL TRANSACTIONS IN THE INTERNET INDUSTRY

A. Overview of the Investigations

Due to the VIE arrangements and other reasons, a huge number of historical concentrations of undertakings in the internet industry which satisfied the notification thresholds have been implemented without notification with the competition authority. The failure of notification is not an isolated phenomenon, but a common phenomenon in the whole internet industry. Till now, the SAMR has publicized 128 decisions⁵ of illegal implementation of concentrations of undertakings in the internet industry since the central government requested to strengthen anti-monopoly law enforcement and prevent the disorderly expansion of capital.⁶ Among the 128 decisions, 127 of which are collectively publicized in 7 batches during the past 3 years,⁷ while the Tencent Holdings Ltd.'s Acquisition of shares of China Music Corporation case (the CMC case) were announced separately.⁸ The 5th batch contains the highest number of decisions so far, which amounts to 43.⁹

2 See https://www.samr.gov.cn/hd/zjdc/202011/t20201109_323234.html (last visited February 8, 2023).

3 See Art 18 of the Guidelines, "The concentration of undertakings involving agreement control (VIE) structure falls within the scope of the anti-monopoly review of the concentration of undertakings. Where the concentration of business operators meets the declaration standards stipulated by the State Council, the business operators shall report to the anti-monopoly law enforcement agency of the State Council in advance, and shall not implement the concentration without declaration."

4 "traffic lights" is a metaphorical term introduced by Central Economic Work Conference 2021 that direct the regulation on investments and financial activities. See http://www.news.cn/politics/2021-12/13/c_1128159713.htm (last visited February 8, 2023).

5 See "Administrative Penalty Cases" Colum on the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, <https://www.samr.gov.cn/fldes/tzgg/xzcf> (last visited February 8, 2023).

6 See "Interpreting the Spirit of the Central Economic Work Conference: Preventing Disorderly Expansion of Capital," on the Chinese government website, http://www.gov.cn/xinwen/2020-12/27/content_5573663.htm (last visited February 8, 2023).

7 See separately:

The 1st batch, the official website of SAMR, https://www.smar.gov.cn/xw/zj/202012/t20201214_324335.html (last visited February 8, 2023);

The 2nd batch, the official website of SAMR, https://www.samr.gov.cn/xw/zj/202103/t20210312_326737.html (last visited February 8, 2023);

The 3rd batch, the official website of SAMR, https://www.samr.gov.cn/xw/zj/202104/t20210430_328470.html (last visited February 8, 2023);

The 4th batch, the official website of SAMR, https://www.samr.gov.cn/xw/zj/202107/t202107_332396.html (last visited February 8, 2023);

The 5th batch, the official website of SAMR, https://www.samr.gov.cn/xw/zj/202111/t20211119_337049.html (last visited February 8, 2023);

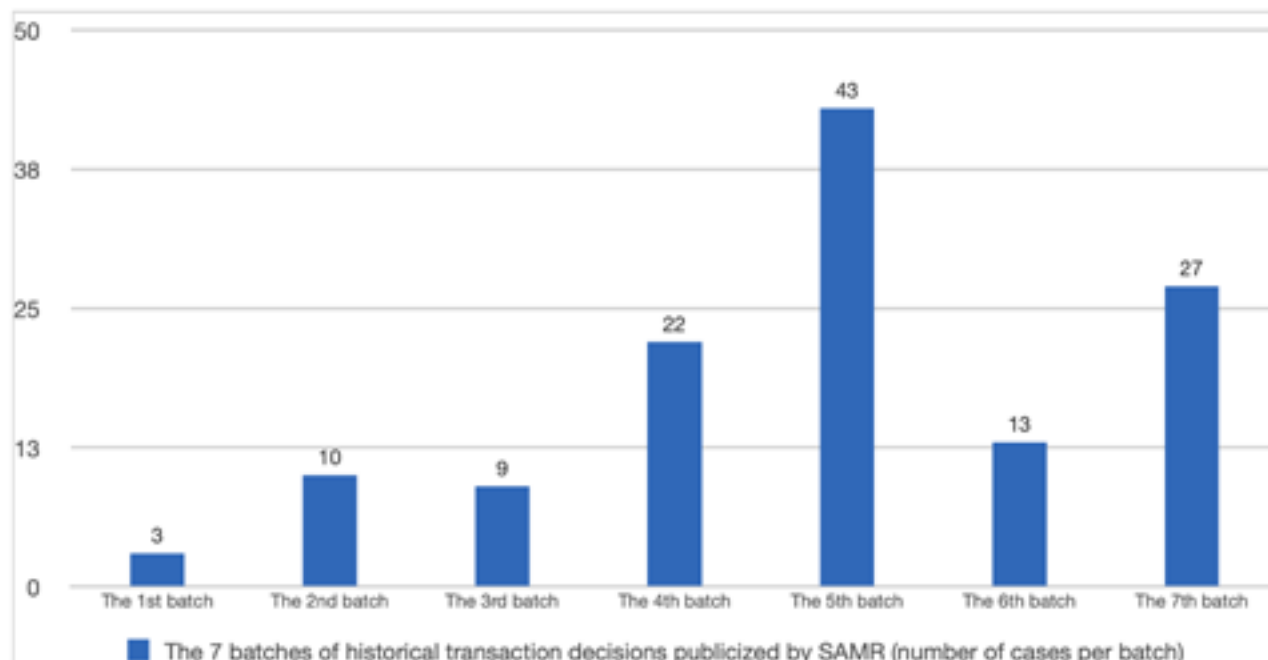
The 6th batch, the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, <https://www.samr.gov.cn/fldes/tzgg/xzcf/> (last visited February 8, 2023);

The 7th batch, the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, https://www.samr.gov.cn/fldes/tzgg/xzcf/202207/t20220710_348523.html (last visited February 8, 2023).

8 See the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, https://www.samr.gov.cn/fldes/tzgg/xzcf/202204/t202204_341604.html (last visited February 8, 2023).

9 See the official website of SAMR, https://www.samr.gov.cn/xw/zj/202111/t20211119_337049.html (last visited February 8, 2023).

Figure1: The 7 batches of historical transaction decisions publicized by SAMR (number of cases per batch)



Most of the investigations show that the failures of notification of concentrations in the internet industry have no impact of restricting and eliminating competition. Among the 128 publicized cases, 127 of which were found of procedural violations of the AML and were imposed with the maximum fine of CNY 500, 000. If you compare the decisions on the failure of notification in other industries in the past, you may find that fines below CNY 500, 000 were imposed on many of the cases. The maximum fine to some extent emphasized the determination of the competition authority to solve the historical transaction issues in the internet industry. According to SAMR, these concentrations have no competition concern and the internet undertakings only gain joint control via minority shareholdings acquisitions for most of the times while the founding shareholders and others often still hold a large percentage of the shares and voting rights.

The merger control in the internet industry exposed the problem of insufficient law enforcement personnel of SAMR and to some extent may lead to the establishment of the National Antimonopoly Bureau (“NAB”). The 128 cases were just a small part of the work for SAMR since every single transaction that happened in the past 12 years in the whole sector has to be analyzed to see if there is a change of control and if the notification thresholds are met. That means tens of thousands of documents need to be run through by the agency. The workload is significant for SAMR to finish within no more than 3 years. Therefore, the enforcement of AML in the internet industry and the objective lack of enforcement capability may be one of the reasons for the expansion of the headcounts of the Anti-Monopoly Bureau afterward. It is partially true that the internet AML investigations have contributed to the establishment of NAB on Nov 18, 2021.¹⁰ A division, particularly for review of concentration in the digital economy area, was founded in the 2nd Antimonopoly Enforcement Bureau.

The CMC case was the only conditional approved historical transaction, and SAMR initiated an administrative investigation procedure that lasted for 180 days.¹¹ This case is of special significance because no historical transactions were imposed with conditions before. The competition concern of the CMC case was the high market share possessed by the merging parties in China’s online music-playing platform market post-transaction (the combined market share of the post-concentration entity exceeds 70 percent in terms of monthly user hours, sales amount, and the share of core music copyright resources), which contributes to a strong unilateral effect. SAMR believed that the unilateral effect was mainly because of the exclusive copyright licensing arrangements and the competition will be restored by breaking the exclusive licensing of upstream copyrights. Therefore, the transaction was imposed with conditions besides the monetary fine of CNY 500, 000. The internet industry is characterized by dynamic competition and cross-border competition, it is also possible that some short video platforms with a broad user base will become competitors in the relevant market with the merging parties in the future after obtaining sufficient music copyrights.

¹⁰ See “The National Anti-Monopoly Bureau Officially Launched,” the official website of SAMR, https://www.samr.gov.cn/xw/zj/202111/t20211118_336974.html (last visited February 8, 2023).

¹¹ SAMR opened the case for investigation on January 25, 2021 and publicized the decision on July 24, 2021. See https://www.samr.gov.cn/xw/zj/202107/t20210724_333016.html (last visited February 8, 2023).

B. The Legal Uncertainties of the Investigations

The reason for the huge number of failures of notifications of concentrations of historical transactions in the internet industry in the past decade is that the VIE structure involves multiple unclear policy issues of various regulatory areas, resulting in vague notification standards in practice. On the one hand, the VIE structure is suspected of bypassing the regulation of foreign investment and telecom value-added services which makes the legality of VIE structure questionable. When a transaction involving VIE structure is submitted to the competition authority, it is therefore difficult for the agency to clarify whether VIE structure-related transactions should be accepted under normal filing procedures. The objective challenges remained unsolved for a long time because different regulators hadn't reached a consensus. On the other hand, most undertakings in the internet industry chose not to make filings with the competition authority for transactions involving VIE structure based on their assessments of the regulatory environment and their own legal risks at the time of the transaction and the AML enforcement agencies didn't actively intervene in these transactions. Under law enforcement agencies' principle of prudential tolerance, undertakings in the internet industry have gradually formed a common concept that they will not notify investment transactions involving VIE structures with the competition authority. However, when the principle of prudential tolerance changed and the competition authority started to investigate the historical transactions involving VIE structures that were not notified in accordance with the law, many challenges followed. The most critical one is, how should law enforcement agencies deal with these long-standing and numerous historical transactions.

At least two legal concepts need further interpretations for solving historical transaction issues. The first one is the concept of "implementation." According to Article 26 of the AML (Art. 21 of the old law), "without notification, the concentration shall not be implemented,"¹² of which "implementation" has always been a vague concept and it needs to be considered with the second legal concept. The second one would be how to interpret the 2-year limitation of administrative enforcement for administrative penalties. Article 36 of China's Administrative Penalty Law states that "where an illegal act is not discovered within 2 years of its commission, administrative penalty shall no longer be imposed." and "if the act is of a continual or continuous nature, it shall be counted from the date the act is terminated."¹³ Therefore, comes the question, for historical transactions, what should be considered to be the starting date for this calculation? The day the transaction was closed (such as the equity transfer settlement or registration and establishment of Joint Ventures) which means the close of the transaction is considered as the act of "implementation"? Or the day when the post-transaction entity (the company) ceases to exist, which means the operation of the company should be seen as a continuous act of "implementation"? If the completion of the transaction itself were to be taken as the point of time for the implementation of the concentration, many historical transactions should no longer be investigated by law enforcement agencies because their "violations" are not continuous acts that exceeded the 2-year time limit; If the post-transaction status is considered as the "continuous" state for implementation of the concentration, the continuing act of "violation" remains intact as long as the company has not deregistered or liquidated, which makes the vast majority of historical transactions subject to SAMR's retroactive investigations.

Due to the ambiguity of these two legal concepts, there is a lot of room for interpretation in practice. Therefore, it is reasonable to say that handling historical transaction issues could be at SAMR's discretion. Different approaches adopted by the agency may have totally different impacts on the market economy. To some extent, the competition authority is seeking a balance between regulating the concentration of undertakings and encouraging market investment by dealing with historical transactions in the internet industry. Anti-Monopoly Law provides a perspective to solve this problem. The purpose of the law is to prevent and restrain monopolistic conducts¹⁴. However, the monopolistic conducts listed in Article 3 only includes "concentration of undertakings that eliminates or restricts competition or might be eliminating or restricting competition"¹⁵, which means concentrations without competition concerns could be excluded from the list. Therefore, for transactions that has no effect of eliminating or restricting competition, the competition authority could consider that the illegal act of "implementation" was

12 See Article 26 of Anti-Monopoly Law: "Any concentration that falls under the notification criteria issued by the State Council must be notified in advance with the State Council antimonopoly authorities. Without notification the concentration shall not be implemented. Where the concentration of undertakings does not meet the notification criteria but there is evidence showing that the concentration of undertakings has or may have the effect of eliminating or restricting competition, the State Council antimonopoly authorities can require the undertakings to notify. If the undertakings do not notify as prescribed by the preceding two paragraphs, the State Council antimonopoly authorities shall conduct an investigation according to law."

13 See Article 36 of Administrative Penalty Law: "Where an illegal act is not discovered within 2 years of its commission, administrative penalty shall no longer be imposed; If the lives, health, and financial security of citizens are involved and there are harmful consequences, the above-mentioned period shall be extended to 5 years. except as otherwise prescribed by law. The period of time prescribed in the preceding paragraph shall be counted from the date the illegal act is committed; if the act is of a continual or continuous nature, it shall be counted from the date the act is terminated."

14 See Article 1 of Anti-Monopoly Law: "This Law is enacted for the purposes of preventing and repressing monopolistic conduct, protecting fair market competition, encouraging innovation, enhancing economic efficiency, maintaining the interests of consumers and public interest, and promoting the sound development of socialist market economy."

15 See Article 3 of Anti-Monopoly Law: "For the purposes of this Law, "monopolistic conduct" includes:

(1) a monopoly agreement reached by undertakings;
(2) an undertaking's abuse of its dominant market position; and
(3) a concentration of undertakings that has or may have an effect of precluding or restricting competition."

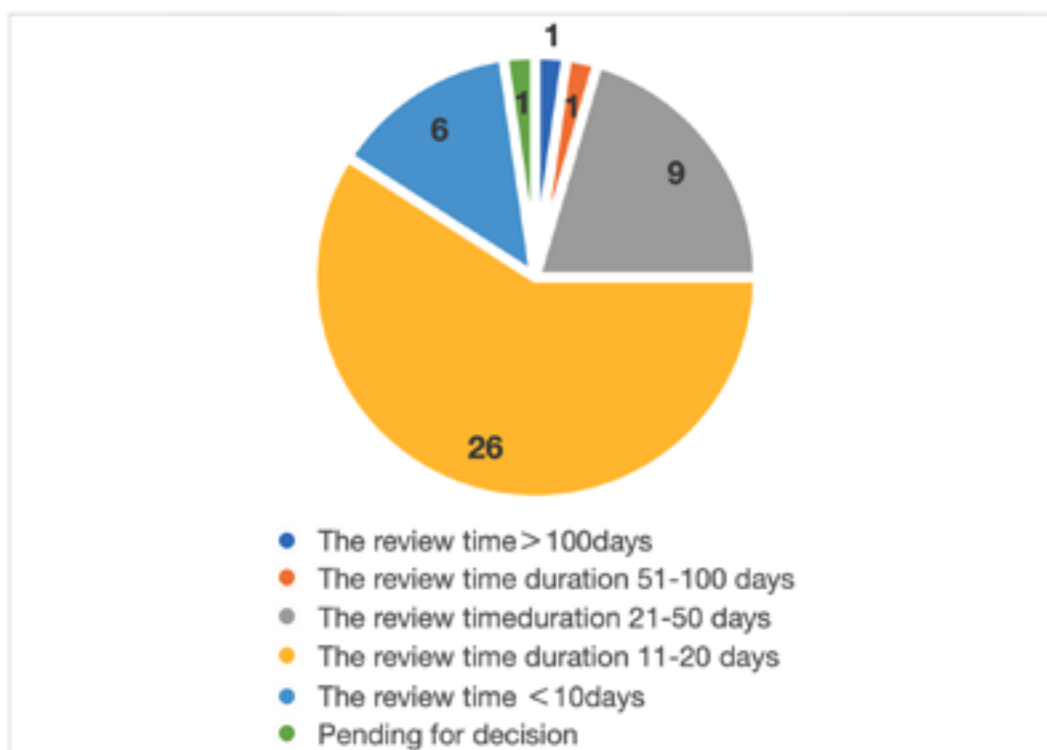
terminated when the transaction was closed; while for transactions that have the impact of exclusion or restriction of competition, the continuous state of “implementation” could be considered terminated when the negative impact on competition disappeared. As the Chinese old saying goes, “ingenuity in varying tactics depends on mother wit”¹⁶, we have no doubt that the historical transactions will be properly handled by the joint endeavor of the regulator agencies and the market players.

II. THE REVIEW OF NEW INVESTMENTS IN THE INTERNET INDUSTRY

A. Overview of the new filings

With the clarification of notification obligation for transactions that satisfied the thresholds, undertakings in the internet industry have gradually strengthened their compliance and notified their new investments with SAMR in accordance with the law. According to statistics, for the new filings in the internet industry, there are only 8 transactions reviewed with standard procedure¹⁷; While more transactions were reviewed under the simplified procedure, the number of which amounts to 44.¹⁸ It is fair to say that there is no difference between concentration of undertakings in the internet industry and the mergers in other sectors in terms of review. We have statistics on the review time of simple cases in new transactions which shows that the longest review time reaches 118 days, and the average review time is about 21 days.¹⁹

Figure 2: The review time for simplified cases in the internet industry



¹⁶ See The History of Song Dynasty - Biography of Yuefei: “Fight after formation is the art of war, ingenuity in varying tactics depends on mother wit.”

¹⁷ See “the publicity of unconditional approval of concentrations of undertakings,” the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, <https://www.samr.gov.cn/fldes/ajgs/wtjz/> (last visited February 8, 2023); and “the announcement of Prohibiting the Anti-monopoly Review Decision on the Merger of Huya Company and Douyu International Holdings Co., Ltd. by SAMR,” the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, https://www.samr.gov.cn/fldes/tzgg/tj/202204/t20220424_342158.html (last visited February 8, 2023).

¹⁸ See “the publicity of simplified cases,” the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, <https://www.samr.gov.cn/fldes/ajgs/jyaj/> (last visited February 8, 2023).

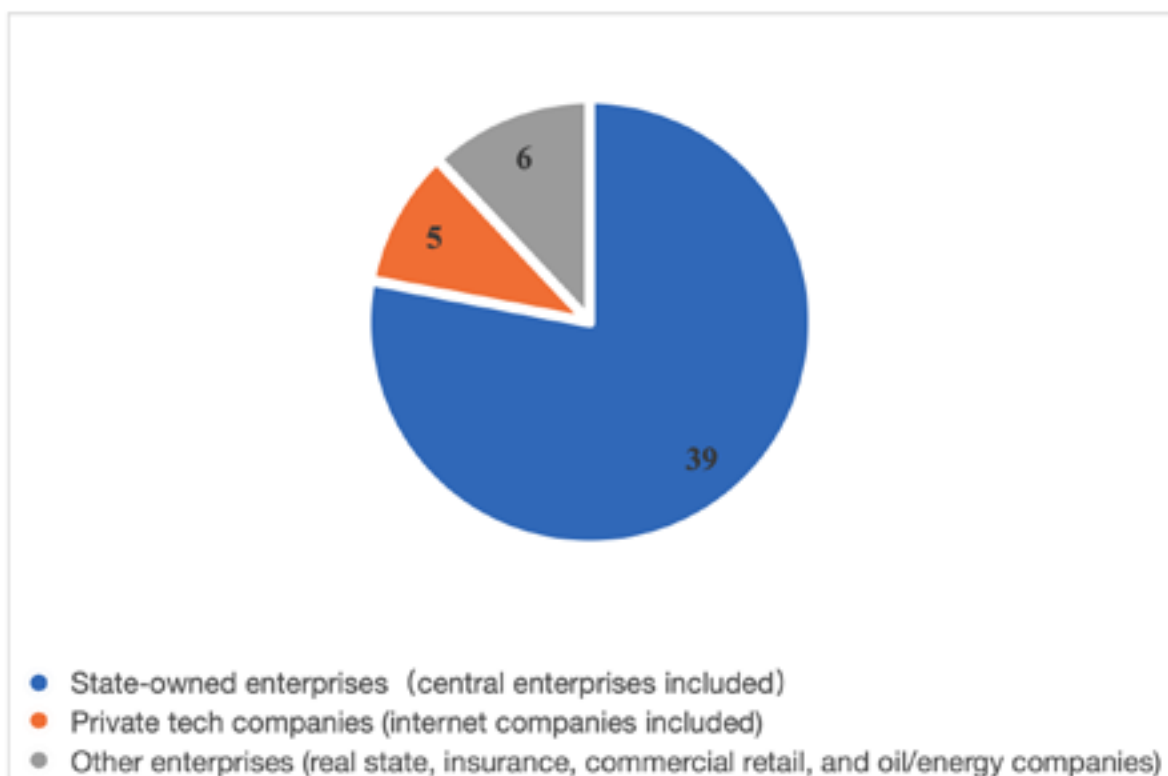
¹⁹ See “the publicity of simplified cases,” the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, <https://www.samr.gov.cn/fldes/ajgs/jyaj/> (last visited February 8, 2023); and the publicity of unconditional approval of concentrations of undertakings,” the official website of the 2nd Bureau of Antimonopoly Enforcement of SAMR, <https://www.samr.gov.cn/fldes/ajgs/wtjz/> (last visited February 8, 2023).

Although the review time of concentrations of undertakings in the internet industry is no longer than that of other sectors, due to the highly dynamic nature of the internet industry, there are still high expectations for the improvement of review efficiency. Excessive review time may delay investment transactions on Internet platforms, which is not conducive to stimulating market vitality and improving economic efficiency.

B. The Proposed Thresholds Based on Market Value or Valuation

Provisions of the State Council on Thresholds for Prior Notification of Concentrations of Undertakings (Draft form comments) released last year²⁰ has proposed to adopt market value or valuation as the notification threshold in addition to the annual revenue standard.²¹ The newly introduced market value and valuation standards in the draft regulation lack a clear calculation standard and are vague, which may bring a large number of investments and mergers and acquisitions into the scope of notification, and are not conducive to encouraging investment innovation. According to statistics, most of the Chinese enterprises with an annual turnover of more than CNY 100 billion in 2021 are State-Owned Enterprises (including central SOEs), and among the qualified private enterprises, the proportion of technology enterprises (including Internet enterprises) is relatively high (see the following chart).²² The new standards will inevitably encounter many uncertainties in the future implementation, including the calculation methodology, the calculation time period, and even the possibility of using other ways to evade this standard. We look forward to the final notification standards that can be refined and optimized with the enforcement practice to better meet market and investment needs.

Figure 3: The top 50 types of enterprises with a turnover of more than CNY 100 billion in 2021 SOE



²⁰ See https://www.samr.gov.cn/jzxts/tzgg/zqyj/202206/t20220625_348150.html (last visited February 8, 2023).

²¹ See Article 4 of the State Council on Thresholds for Prior Notification of Concentrations of Undertakings (Draft form comments): Undertakings that do not meet the notification thresholds specified in Article 3 of this Regulation but meet the following conditions shall, prior to implementation of concentration, notify with the Anti-Monopoly enforcement authority of the State Council:

(1) the turnover of one of the undertakings participating in the concentration in the last accounting year in China is more than CNY 100 billion;
 (2) the market value (or valuation) of the other undertakings specified in Item (1) of Paragraph (1) or Items (2) and (3) of Paragraph (2) of Article 2 of this Regulation is not less than CNY 800 million, and the turnover of the undertaking in China in the last accounting year accounts for more than one-third of its turnover globally.

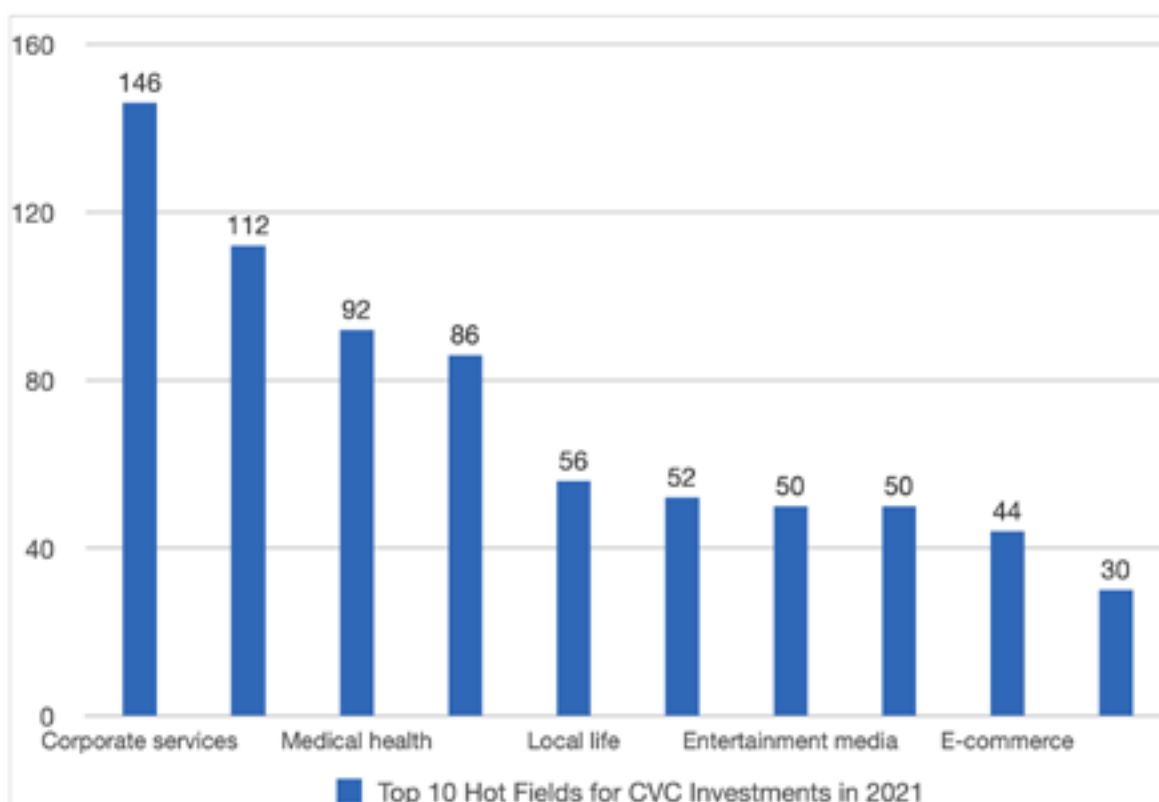
²² See "2021 Top 500 Chinese Enterprises," <https://finance.sina.com.cn/china/2021-09-25/doc-iktzscyx6201643.shtml> (last visited February 8, 2023).

C. On Optimizing the Regulation of Concentrations in the Internet Industry

The necessity of optimizing the AML merger review system for undertakings in the internet industry

General Secretary Xi Jinping pointed out that we need to continuously strengthen, optimize and expand our digital economy and set up "traffic lights" for capital. The AML merger review system is an important tool to play the role of the "traffic lights" to regulate and guide the healthy development of capital and promote the healthy and sustained development of the digital economy in accordance with the law. The Internet industry is characterized by strong dynamics and fleeting transaction opportunities, so its system of merger review also needs to cater to the industry characteristics to introduce a set of rapid and efficient mechanisms to promote investment and mergers and acquisitions ("M&A") and improve economic efficiency. Investment and M&A in the Internet industry are the main force of CVC (corporate venture investment) in China. According to itjuzi.com, as of August 31, 2021, the total number of investment events of Internet companies accounted for 58 percent of the total CVC investment in China.²³ Compared with PE/VE, CVC usually plays a more patient role in the target company, which means they can accompany enterprises to grow for a long time. This is of significant importance for startups to obtain financing support and sustainable development. In particular, it is worth noting that CVC investment is mostly related to industries with national strategic significance. According to itjuzi.com, the industry with the most CVC investment events in 2021 was corporate services (146 events), advanced manufacturing (112 events) and medical health (92 events) (details in the following chart).²⁴ This is of great significance for empowering the real economy, promoting digital transformation, strengthening technological innovation and tackling core technologies in key fields, and is conducive to the country's strategic experiments. Therefore, it is urgently necessary to further optimize the concentration regulation mode of the internet industry.

Figure 4: Top 10 Hot Fields for CVC Investments in 2021



D. The Principles for the Optimization

It is necessary to adhere to the principles of equal regulation, professional regulation and collaborative regulation in optimizing the management of Internet industry operators. Firstly, the principle of equal regulation should be adhered to, and the same level of supervision should be given to different industries without discrimination. Secondly, the principle of professional regulation should be adhered to. On the one hand, we should

²³ See "2021 China CVC Investment and M&A Report," <https://cdn.itjuzi.com/pdf/b3bdf9b55cac58721d39cee2f106e632.pdf> (last visited February 8, 2023).

²⁴ *Ibid.*

strengthen the professional training of anti-monopoly enforcement teams, and establish a mechanism for more antitrust experts to involve in the training sessions and even the enforcement of the law; On the other hand, we should actively recruit talents with the professional antitrust background to join the anti-monopoly enforcement agencies and expand the regulation team staffing appropriately. Thirdly, the principle of collaborative regulation should be adhered to, and an "anti-monopoly community" should be built to facilitate the exchange and cooperation mechanism between anti-monopoly enforcement agencies, judicial branches, corporate compliance departments, research institutions of universities and law firms, which can contribute to deepen consensus, cultivate competition culture. These are conducive to the harmony of administrative enforcement and litigation, the coordination of compliance and regulation, and the mutual promotion of theory study and practice.

Optimizing the regulation of the concentration of undertakings in the internet industry: Improving the categorization and classification review system

Article 37 of the revised Anti-Monopoly Law states: "The anti-monopoly enforcement agency of the State Council shall establish a categorization and classification system for concentration of undertakings, strengthen the review of concentration of undertakings in key fields that concern national economy and people's livelihood, and improve the quality and efficiency of the review."²⁵ The establishment of a categorization and classification review system for concentration of undertakings is conducive to setting the "traffic lights" for the investment and M&A of Internet platforms, which can provide more guidance for future investments.

Firstly, with reference to the negative list, it is necessary to clarify the "red light" areas and make it clear that all areas outside the "red light" areas can be invested. By dynamically updating the "Internet Market Access Prohibited License Catalog" and other laws and regulations, setting "red lights" for a few sensitive areas that may affect national security and stability, public opinion, and social mobilization capabilities, so that market players can clearly define the boundaries of prohibition. Outside the "red light" field, we should uphold the principle of "everything which is not forbidden is allowed" to improve the expectations of market players and boost development confidence.

Secondly, it is necessary to launch the "green light" cases as soon as possible and clarify the supporting measures to these cases to encourage investment. The report on the development of the digital economy made by Mr. He Lifeng, director of the National Development and Reform Commission, to the National People's Congress pointed out that it is necessary to support and guide the healthy and sustainable development of the platform economy, and to launch a batch of "green light" investment cases²⁶. The key to launching "green light" cases lies in the timely introduction of incentives and support for this field of investment and M&A. In terms of concentration of undertakings, a fast review mechanism can be set up for the investment and M&A in the "green light" field to shorten the review time period, so as to enable these investments and M&As that are conducive to building new national competitive advantages to be implemented more quickly.

Finally, it is necessary to reduce the "gray area" between "red and green light" areas as much as possible to prevent the stagnation of investment and M&A. Under the situation of normalized supervision, enterprises may reduce investment and M&As in the "gray area" to avoid possible policy risks. If the scope of the "gray area" is too large, it may cause the scope of the enterprises' "fear of investing" to expand, which may lead to problems such as difficulty in financing for small and medium-sized enterprises, decline in market vitality, and reduction of economic efficiency.

²⁵ See Article 37 of Anti-Monopoly Law.

²⁶ See https://www.ndrc.gov.cn/fzggw/wld/hlf/ddt/202211/t20221116_1341446.html (last visited February 8, 2023).



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