Legal Commentary

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Revision Draft of the Chinese Anti-Monopoly Law – What to Expect

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Key takeaways from the Revision Draft:

1. Holds liable **undertakings organizing or assisting the reaching of a monopoly agreement** in the same manner as participants in the monopoly agreement.
2. Introduces the **indispensability test** in addition to other tests to qualify for a monopoly agreement exemption, could further increase the difficulty in applying for exemptions.
3. Grants SAMR the right to adjust **Merger filing thresholds** to adapt to market changes.
4. Highlights **Authenticity of submitted documents and materials**, fines rise substantially for fraudulent materials or information.
5. Introduces **Stop-clock rules** for merger reviews, which could replace the current practice of withdrawal and refiling upon expiry of the 180-day statutory time limit.
6. Increases maximum fines to **RMB 50 million** in cases where cartels are reached but not implemented and where cartels are reached but the member(s) had no sales revenue in the previous year.
7. Increases maximum **fines for industry associations** to **RMB 5 million**.
8. Substantially raises maximum **fines in gun-jumping cases** to **10% of the sales revenue of the previous year**, which is expected to encourage filings to be made in general (and, in particular, will force undertakings to file for VIE-related transactions and VCs to reduce their veto rights to avoid triggering merger filings).
9. Formally introduces **criminal sanctions** as a consequence of violations, subject to criminal law provisions.
10. Substantially raises fines for **refusal or obstruction of investigation and review**.

On January 2, 2020, the first working day of the third decade of this century, the State Administration for Market Regulation ("**SAMR**") issued for public comment a revision draft (the "**Revision Draft**") of the *Anti-Monopoly Law of the People's Republic of China* (the "**AML**"). Efforts to revise the AML formally began several years ago with the State Council releasing the Legislative Work Plan for 2015, and revising the AML was listed on the legislative work plan of the Standing Committee of the 13th National People's Congress (the "**NPC**") in 2018. Centering around these revisions, guided by the Anti-Monopoly Committee under the State Council, SAMR is soliciting public comments from a broad array of stakeholders so as to revise the AML pursuant to both local and international experience to address crucial and vexing problems facing practitioners. The Revision Draft is SAMR's first public step toward revising the AML. In principle, following this step, SAMR will modify the Revision Draft in response to public comments and submit it for review to the Ministry of Justice, which will further modify the submitted draft including suggestions and opinions from stakeholders. Thereafter, the Ministry of Justice will submit its own draft to Legislative Affairs Commission of the NPC Standing Committee. Then, the NPC Standing Committee will also release consultation drafts and seek one or more rounds of public comments before finally adopting the revisions and amending the AML. The legislative process often takes years, making the timeline difficult to predict. At present, revising the AML is classified in the legislative work plan as a Category 2 priority. We therefore believe that it could take five years or more to revise the AML, from its initial inclusion in the legislative work plan in 2018 until adoption of the revisions. That said, the legislative process can in theory be simplified or expedited for the NPC Standing Committee to deliberate and pass the final revisions to the AML.

The Revision Draft proposes revisions that reflect the requirements of law enforcement in practice, which could have a profound impact on different industries and markets. The revisions are not complex and mostly concern revising wordings in relation to concentrations of undertakings. That said, the potential effect of these revisions on anti-monopoly enforcement may prove to be comprehensive. Here, we select several key points from the Revision Draft for the purpose of revealing the origins, possible considerations, and potential effects of such revisions.

Fair Competition Review System ("FCR System") and the fundamental position of competition policies

The State Council promulgated the *Opinions of the State Council on Establishing a Review System for Fair Competition in the Course of Building the Market System* in 2016, raising the curtain on the FCR System. Thereafter, five departments constituting or under the State Council circulated the *Rules for Implementation of the Fair Competition Review System (Interim)* in 2017, facilitating the establishment of the FCR System nationwide. With respect to the FCR System, the Revision Draft imposes active obligations on administrative departments and confirms the Anti-Monopoly Committee under the State Council as the coordinator, a move popular among various stakeholders.

At the end of 2018, the Central Economic Work Conference put forward for the first time the policy to "strengthen the fundamental position of competition policies," which is incorporated into Article 4 of the Revision Draft. While the Revision Draft does not contain the principle of "competitive neutrality," the fact that the "fundamental position" of competition policies may become a general provision of the AML

suggests that competition policies and an institutional environment for fair competition are gaining more ground in the economic system.

Identification of monopoly agreements and abuse of dominant market positions

I. Monopoly agreements

Two changes proposed in the Revision Draft targeting monopoly agreements are particularly eye-catching. First, Article 17 adds that "undertakings are prohibited from organizing and assisting other undertakings to reach monopoly agreements." Further, Article 53 provides that the legal liability of undertakings in a monopoly agreement also applies to the undertakings which organize and assist those undertakings to enter into the monopoly agreement. Combined with the general definition of monopoly agreements provided as a separate Article 14, complicated scenarios in practice may be addressed effectively which do not constitute traditional horizontal and vertical monopoly agreements (note, however, monopoly agreement exemptions provided in Article 18 of the Revision Draft do not explicitly apply to Article 14, which implies that regulators may not cite Article 14 alone in enforcement actions). For example, in dealing with hub-and-spoke cartels, competition authorities would have new enforcement tools and not be limited to proving vertical relationships; moreover, in addition to industry associations, conference organizers and market research institutions, etc. could also fall under the jurisdiction of the AML, provided that such entities have sufficient knowledge of the nature of the monopolistic conduct at issue.

Second, currently, two tests must be satisfied for monopoly agreements to be exempted under the AML: it must be proven that the agreements will "not substantially restrict competition in the relevant market" and that they will "enable the consumers to share the benefits derived therefrom." The Revision Draft adds that "the agreements reached shall be indispensable for achieving the desired objectives," further specifying the conditions for exemption for the purpose of ascertaining the indispensability of restrictive arrangements, but also making it more difficult to qualify for the exemption. That said, the indispensability test is not a new concept in China, it has been proposed indirectly by the National Development and Reform Commission in a public comment draft of the *Guidelines on the General Conditions and Procedures for Exemption of Monopoly Agreements (Draft for Comment)*, which provides in Article 7 that account must be taken of "(2) causation between the agreement and the circumstances realized; (3) the importance of the agreement to realizing the circumstance."

II. Abuse of dominant market position

Certain revisions also deserve attention in the chapter on abuse of dominant market position. First, Article 20 of the Revision Draft adjusts the tests for differential treatment by deleting the "same conditions" test. "Same conditions" has always been a prerequisite for differential treatment in China's antitrust rules; the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions,* promulgated by SAMR, clarifies in Article 19 that the meaning of "same conditions" is "there are no differences that substantively affect transactions between the transaction counterparties in terms of transaction security, transaction cost, scale and capability, credit status, transaction process involved, duration of transaction, and other aspects." That said, we expect that in practice, even without the "same conditions" test, undertakings holding dominant market positions could also rely on legitimate reasons to justify their transaction terms.

Second, in identifying dominant market positions under Article 21, factors are introduced regarding the dominant market positions of undertakings in the internet industry and other fields of the new economy, including but not limited to network effects, economies of scale, lock-in effects, and data resources. Such factors have been used in practice and are stipulated in Article 11 of the *Interim Provisions on Prohibiting Abuse of Dominant Market Positions*. Now, these factors may be confirmed in the form of law rather than merely in departmental rules.

Third, the Revision Draft makes no mention of "relative advantageous positions," which may ease the concerns of some undertakings.

Merger control

Merger control is the big-ticket item of the Revision Draft. The corresponding revisions incorporate certain rules prescribed in supporting rules and regulations, and reflect the experiences of law enforcement in merger control. We find the following aspects to stand out among the revisions proposed in the Revision Draft:

First, Article 24 authorizes SAMR to adjust merger filing thresholds pursuant to the development of the economy, the scale of industries, and other factors, to keep pace with the times. Merger filings are currently subject to two fixed thresholds pursuant to the *Provisions of the State Council on Notification Thresholds for Concentrations of Undertakings*.

Second, the Revision Draft highlights the authenticity of documents and materials submitted for review. Article 26 adds a new clause providing that undertakings shall "be responsible for the authenticity of such documents and materials," and Article 51 further provides that SAMR may carry out an investigation pursuant to law and revoke the original review decision in the case of inauthenticity or inaccuracy of such documents and materials, either at the request of an interested party or ex officio. SAMR relies heavily on documents and materials submitted by filers in their merger control reviews, hence they champion authenticity of such documents and materials. Article 59 targets the submission of fraudulent materials and information by raising fines against entities from RMB 200,000 (normal violations) or RMB 1 million (serious violations) to no more than 1% of the sales revenue of the previous year or RMB 5 million (no sales revenue or revenue being difficult to calculate), and raises fines against individuals from RMB 20,000 (normal violations) or RMB 100,000 (serious violations) to between RMB 200,000 and 1 million. Article 59 of the Revision Draft increases fines substantially, which would increase the importance of compliance.

Third, Article 30 adds new stop-clock rules through prescribing three scenarios under which the elapse of time does not count toward the review period. These three scenarios are all necessary in practice: "upon application or consent by the notifying parties," "supplementary submission of documents and materials" and "consultation in relation to proposals for restrictive conditions." Currently, in the absence of stop-clock rules, it is common practice to withdraw and subsequently re-file transactions when the review period is running out. The establishment of stop-clock rules would predictably reduce the frequency of such practices, and we look forward to more detailed rules in this regard which support procedural transparency.

Fourth, for concentrations smaller in scale but which have the effect of potentially restricting or eliminating competition, Article 24 introduces that an investigation is to be carried out where a concentration of

undertakings does not reach the merger filing thresholds but has or might have the effect of restricting or eliminating competition, a provision currently found in the *Provisions of the State Council on Notification Thresholds for Concentrations of Undertakings*. Article 34 further provides that such concentrations may be subject to unconditional or conditional approvals or prohibitions. For implemented concentrations, measures may be required to restore the status of competition prior to the concentration. Article 34 further confirms SAMR's power to initiate investigations against concentrations, and could prompt (or even normalize) the filing of transactions that fall short of merger filing thresholds but involve large market shares, while at the same time rendering uncertain certain deals that have closed.

Fifth, Article 55 increases the maximum fines in gun-jumping cases from RMB 500,000 to no more than 10% of the sales revenue of the previous year. The substantial increase in fines would partly unify with fines for monopoly agreements and abuse of dominant market positions. This revision could lead to a significant rise in the number of filings; but if combined with the potential adjustment of merger filing thresholds, SAMR may be more effective in its work while maintaining a stable workload. If the revisions are adopted in their current form, circumstances regarding VIE-related transactions and venture capital investments could be particularly interesting to watch. While SAMR has in the past shied away from VIE transactions, the regulator may finally have to tackle this issue head-on if market players make VIE-related filings en masse due to the enhanced fines. Venture capital funds that obtain important veto rights while neglecting the filing requirement could need to either make the filings or forgo such rights.

Investigations

With respect to investigations, we find the following aspects of the Revision Draft to be noteworthy. First, Article 44 provides that the public security departments will assist with investigative measures against suspected monopolistic conducts; this would assure the effective implementation of investigative measures such as investigating business premises, interviewing employees, reviewing and duplicating documents and materials, and seizing and taking custody of evidence.

Second, on commitments of undertakings, Article 50 of the Revision Draft forbids any suspension of investigations against cartels involving prices, quantities, and market partition, incorporating Article 22 of *Interim Provisions on Prohibition of Monopoly Agreements*.

Third, Article 53 raises the maximum fines from RMB 500,000 to RMB 50 million, which targets scenarios where monopoly agreements are reached but not implemented, and where monopoly agreements are reached but the undertakings had no sales revenue in the previous year. For industry associations, the maximum fines increase from RMB 500,000 to RMB 5 million. These revisions could increase the deterrent effect of the fines against such misconduct.

Legal liabilities

Legal liabilities are another important change in the Revision Draft. Particularly regarding maximum fines in gun-jumping cases, the tone from the antitrust community has been more or less the same – raise it up. We have mentioned above several revisions on legal liabilities, here we summarize the revisions on legal liabilities below for further analysis:

1. On reaching and implementing monopoly agreements, the Revision Draft maintains legal liabilities including ordering discontinuance of violations, confiscating illegal gains, and imposing a fine between 1%-10% of the sales revenue of the previous year. Where monopoly agreements are reached but not implemented, and where monopoly agreements are reached but the undertakings have no sales revenue in the previous year, the maximum fines increase from RMB 500,000 to RMB 50 million; for industry associations, the maximum fines increase from RMB 500,000 to RMB 5 million.

2. On abuse of dominant market positions, the Revision Draft retains the previous legal liabilities.

3. On merger control, Article 55 specifies that gun-jumping consists of (1) implementing a notifiable concentration without filing; (2) implementing a notifiable concentration without obtaining clearance after filing is made; (3) violation of conditional approval decisions; and (4) implementing a concentration in violation of injunctions. Categories (1) and (3) are specified in the *Interim Measures for Investigation and Handling of Failures to Give Prior Notification of Concentrations of Undertakings* and the *Provisions on Imposing Additional Restrictive Conditions on Concentrations of Undertakings (for Trial Implementation)*, category (2) provides legal consequences for violating Article 24, and category (3) corresponds to Article 32.

4. On merger control, based on the four categories, the Revision Draft maintains legal liabilities including ordering discontinuance of concentrations, ordering disposal of shares or assets within a time limit, ordering transfer of businesses within a time limit, and adoption of other necessary remedial measures to return to the state prior to the concentration, and adds three new remedial measures based on restrictive conditions – imposing and changing restrictive conditions and ordering continued performance of restrictive conditions. More importantly, the Revision Draft raises the maximum fines in gun-jumping cases from RMB 500,000 to no more than 10% of sales revenue for the previous year. The substantially increased fines would partly unify with the fines for monopoly agreements and abuse of dominant market positions.

The approach to defining the sales revenue base used in determining fines awaits further clarification. We note there could be disparities among fines for different monopolistic conducts if SAMR were to impose fines in gun-jumping cases by calculating the sales revenue base by considering all products and all regions while continuing to limit geographic and product scopes when imposing fines for monopoly agreements and abuses of dominant market positions.

Another issue concerning administrative penalties is the retroactivity of the revised AML for deals closed prior to its effectiveness. Article 29 of the *Law on Administrative Penalty* provides that administrative penalties will not be imposed where the illegal conduct is not discovered by the authorities within two years of its commission, unless otherwise prescribed by law. The two-year period is considered to "be counted from the date the illegal conduct is committed; if the conduct is of a continual or continuous nature, it shall be counted from the date the conduct is terminated." SAMR (and its predecessor, MOFCOM) appear to view gun-jumping as of "a continual or continuous nature," because they have penalized transactions that have been closed for over two years. The *Law on Administrative Penalty* does not address how revisions of law apply to punishment of illegal conduct that is continual or continuous and exists both pre- and post-revision (*i.e.*, committed under the preceding AML, but extends to the period after the revised AML takes

effect). In similar situations under the *Criminal Law*, however, the principle is to apply the revised law. As a result, filers of such gun-jumping cases closed under the preceding AML potentially face the risk of being penalized under the revised AML and thus subject to fines far higher than the current maximum amount of RMB 500,000. We expect transition rules or further guidance to be issued to address such circumstances.

Moreover, the Revision Draft adds "eliminate the consequences of the illegalities" among factors provided in Article 56 to determine the amounts of fines. In practice, this factor has been widely referenced and can also be found in penalty provisions in the *Guidelines on Recognizing the Illegal Gains Obtained by Undertakings from Monopolistic Conduct and Determining the Amounts of Fines (Draft for Comment)*.

Article 57 adds criminal sanctions in addition to existing civil liabilities – "[w]here a crime is constituted, the relevant undertakings shall be subject to criminal liabilities." Currently, bid rigging, rigging prices of stocks or futures, and other monopoly-related conducts are already included in the *Criminal Law*. This provision in Article 57 reaffirms the position of regulators to criminalize certain monopolistic conducts.

For refusal or obstruction of investigations and reviews, Article 59 of the Revision Draft raises fines for enterprises from RMB 200,000 (normal violations) or RMB 1 million (serious violations) to no more than 1% of the sales revenue of the previous year or RMB 5 million (no sales revenue or revenue being difficult to calculate); and raises fines for individuals from RMB 20,000 (normal violations) or RMB 100,000 (serious violations) to between RMB 200,000 and 1 million. The proposed increase in fines should ensure the orderly handling of enforcement actions.

Investigations

Since its entering into force in 2008, the AML has gained more weight in the socialist market economy and civil life: the number of law-enforcement cases and the amount of fines are increasing, and market competition is protected by relying on these diligent efforts. Beginning in this new decade, the AML should and will play a bigger role in the market. The Revision Draft summarizes and addresses certain problems facing practitioners, but still needs to be perfected by taking into account the opinions of a wide spectrum of stakeholders both inside and outside the antitrust community. It remains to be seen how revisions to the AML will further take shape following the public comment period.

Important Announcement

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