CHINA'S SAMR SIGNALS ENFORCEMENT FOCUS ON DIGITAL SECTOR WITH DRAFT ANTITRUST GUIDELINES ON THE PLATFORM ECONOMY SECTOR

17 December 2020 | Greater China
Legal Briefings

China's State Administration for Market Regulation (**SAMR**) published its consultation draft of the Antitrust Guidelines on the Platform Economy Sector (the **Guidelines**) on 10 November 2020, one day before the widely anticipated annual "Double Eleven" shopping event (broadly similar to Black Friday and Cyber Monday widely observed in other countries), signalling a renewed focus on antitrust enforcement within the sector and leading to major dips in the share prices of many major internet companies.

The structure of the Guidelines broadly follow the framework of the AML providing sector specific guidance in relation to each of the key aspects of the law: relevant market definition, prohibition of monopoly agreements, prohibition abuses of dominance, merger control and abuses of administrative power. In this briefing, we take a closer look at some of the key takeaways from the Guidelines.

Enforcement objectives

The Guidelines emphasize that antitrust enforcement in the sector will strike a balance between preventing anti-competitive behaviour, and promoting the healthy development of platform economies. This echoes previous public statements by SAMR officials that the approach to enforcement in the digital sector is a balance between 'tolerance' and 'prudence', in order to avoid stifling the momentum of technological and commercial innovation.

In particular, the Guidelines state that enforcement activity will be based on balancing the following fundamental principles:

1. Maintaining an order of fair competition;
2. Strengthening effective and 'scientific' regulation;
3. Encouraging innovation and creativity;
4. Fostering healthy growth in the industry; and
5. Protecting the legal rights of all stakeholders.

Relevant market definition

Although the Guidelines note that the market definition exercise should follow general principles applicable in all cases, they also note certain sector specific factors that should be considered in this process. Furthermore, the Guidelines recognise that defining the relevant market may be difficult in platform related cases due to the complex nature of business activities and the multi-sided nature of many platforms.

Whilst it may not always be necessary to define a relevant market in cases involving anti-monopoly agreements, defining the relevant market is typically the first step in any abuse of dominance case. However, in cases where it is difficult or impossible to define the relevant markets, but where the factual circumstances show a lasting and harmful pattern of anti-competitive behaviour that could only be sustained by a dominant undertaking, the Guidelines suggest it may be possible to skip the market definition exercise.

In most major antitrust regimes, market definition remains at the heart of enforcement and therefore this mechanism is certainly novel. Whilst the Guidelines set out a reasonably high threshold on the factual context before SAMR may resort to this approach, it remains to be seen how easily or frequently this provision may be invoked in future enforcement cases. If this provision becomes frequently used in cases involving platform operators, this could have a fundamental impact on the way the law is applied in future, and this may also spill over into enforcement over other sectors.

Monopoly agreements

The Guidelines restate the general principles applicable to anti-competitive agreements (known as "monopoly agreements" under the AML), but specify various sector-specific circumstances in which platforms may engage in monopoly agreements.

The Guidelines deal with a number of key topics that are prevalent in the digital sector, including:

- **Use of 'technical methods' to achieve horizontal or vertical monopoly agreements:** which includes a wide range of examples such as the collection of competitively sensitive information through platforms, the use of data and algorithms to achieve horizontal coordinated or collusive conduct; and the use of platform restrictions, data and algorithm to achieve resale price maintenance.
- **Most Favoured Nation, or MFN, clauses:** which shall be subject to an effects based analysis, taking into account relevant factors such as the commercial motives of the contracting parties and their market power in a relevant market.
- **Exclusivity arrangements:** which again shall be subject to an effects based analysis, taking into account relevant factors such as the market power of the platform operator, competitive landscape in the relevant market, and barriers of entry by other competitors.
- **Hub and spoke arrangements:** which can be achieved by competitors through platforms, or indeed be organised by the platform itself. In order to identify whether an infringement has taken place, it should be considered whether 'technical methods', platform restrictions, data and algorithms have been used to achieve an agreement that forecloses or restricts competition in the market.

Abuse of dominance

The Guidelines set out a number of key factors that may be relevant in identifying a dominant undertaking, including:

- **Market share and competitive landscape of the relevant market:** in assessing market share, the Guidelines state that this can be achieved through considering a variety of factors, including size of user base, length of engagement time of users and number of 'clicks' or 'hits'; whereas in assessing the competitive landscape, the Guidelines suggest considering the number of competing platforms, as well as the characteristics and divergence between platforms.
- **Market power exercised by the undertaking:** which may involve consideration of

factors such as the business model of each platform, network effects, ability to influence the flow of users.

- **Financial strength and technological advancement**
- **Reliance of other undertakings in trading**
- **Barriers to entry**

The Guidelines also discuss a number of abusive conduct in the context of platform operators and the relevant factors for assessing each type of conduct, including:

- **Unfair pricing,** which can occur either when selling products at unfairly high prices or procuring products at unfairly low prices. Relevant factors for assessment include whether prices are significantly higher or lower than those of other platforms operators (or sold on other platforms by the similar sellers) in similar markets, and where prices are significantly increased/decreased without any clear fluctuation in cost of input.
- **Predatory pricing,** which occurs when sales are made at prices below cost. The key question to be considered is whether prices are kept below cost in order to drive out other competitors, and subsequently whether prices gradually increase.

  However, predatory pricing may be justified if, for example, it is used for a reasonable period to promote other business activities of the platform or to promote the entry of a new product.

- **Refusal to deal,** which can foreclose or restrict competition if it involves suspension or termination of existing transaction arrangements, refusing to engage in new transactions with existing counterparties, restricting or preventing transactions through the use of platform restrictions or control of traffic etc., and refusal to supply an essential facility.

  As to whether data or a particular platform itself constitutes an essential facility, factors that are relevant for consideration include as the substitutability of other platforms, reliance of undertakings on a particular platform, the indispensability of data in a particular market and the existence of similar data sources.

Refusal to deal may be justified if, for example, entering into the transaction may cause the platform operator to suffer harm or loss, or if the counterparty refuses to adhere to fair and reasonable terms set by the platform operator.

- **Exclusivity/loyalty inducing arrangements,** which may take the form of explicitly requiring exclusivity, requiring counterparties to transact with specified third parties, or preventing counterparties from transacting with specified third parties. The Guidelines also address contractual restrictions to “choose one between two”, which refers to the prevalent practice of many platforms to require sellers on its platform (for example) to engage in promotional activities only on its platform, without imposing a broader requirement of exclusivity. The key question to be considered is whether the platform operator rewards (for example through rebates, discounts, or increasing traffic) or penalises (for example through demoting search results, restricting traffic or imposing other technical barriers) sellers on its platform to enforce the arrangements.

Exclusivity or loyalty inducing arrangements may be justified if, for example, they are necessary to protect IP rights or data security, if they are necessary to justify transaction-specific investments or if they are necessary for the reasonable maintenance of the platform’s operations.

- **Tying and other unreasonable contractual terms,** which may relate to a wide range of issues including payment method, provision after sales services, additional and unreasonable charges, as well as collection of user data.

These contractual terms may be justified if, for example, they are necessary for protecting consumer welfare, improving efficiency or maintaining the platform.

- **Discriminatory treatment,** which include discriminatory pricing, applying different algorithms or standards to similar transactions, and imposing discriminatory payment terms or other transaction terms. This provision is particularly targeted at personalised pricing through data analytics and algorithmic pricing, which is garnering significant public attention in China.

Discriminatory treatment may be justified if, for example, they are short term promotions aimed at new users, or if the platform can show that the transactions arise due to the application of fair and non-discriminatory algorithms or programs.

Merger control

As to merger control, one highlight is that the Guidelines explicitly state that transactions involving undertakings adopting a variable interest entity (**VIE**) structure are notifiable for SAMR's review.

The VIE structure is widely used by domestic Chinese companies in sectors restricted from seeking financing overseas and is especially common in Chinese tech companies that are listed abroad. However, there was considerable uncertainty as to the notifiability of transactions involving VIE structures in the past, as SAMR (and its predecessor, the Ministry of Commerce) has not previously accepted any filings involving VIE structures.

This position changed earlier in 2020, when SAMR publicised its first case involving a VIE structure, and is further bolstered by the explicit statements made in the Guidelines.

The Guidelines also state that it may actively investigate the following types of transactions, even if they do not meet the notification thresholds: (i) transactions involving start up platforms or companies; (ii) transactions involving operators that do not generate substantial turnover due to offering its services for free or very low cost; and (iii) transactions in highly concentrated markets. Parties to such transactions may also proactively notify their transaction even if they do not meet the notification thresholds.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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