China’s Recent Competition Developments: 2019 in Review

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With years-long trade tensions between China and the United States, companies conducting business in both countries face new and escalating uncertainties (uncertainties now magnified exponentially by the unpredictable implications of the COVID-19 pandemic). Trade and export controls in one country can conflict with competition policy in the other. Requirements are evolving quickly; new measures are introduced regularly. Even with the countries’ recent Phase I trade agreement, these complex and shifting conditions can lead to confusion about on-the-ground competitive conditions and the laws framing them.

The year 2019 saw China and the United States whipsaw between claims of a trade agreement and accusations of unlawful market behavior. The countries engaged in tit-for-tat actions meant to punish foreign companies perceived as threats to national interests or domestic industries. And they did so even as China eased its traditional restrictions on market access and explored new methods to exert control over market behavior. Against this backdrop, China’s courts and enforcers have been grappling with the reach and the meaning of the country’s antitrust statute, the Antimonopoly Law (AML), which is only eleven years old and is expected to undergo its first major revisions in 2020. ¹

In this article, we seek to untangle this complicated situation and highlight some of the most notable developments and rulings from 2019 that are likely to impact foreign companies operating in China.

Key Antitrust Developments

Resale Price Maintenance. In June 2019, the Chinese Supreme Court published a ground-breaking decision on resale price maintenance (RPM), a practice through which a manufacturer and a distributor agree on the minimum prices at which the distributor will resell the manufacturer’s products. The Court ruled in Yutai v. Hainan Provincial Price Bureau that China’s antitrust enforcers need not prove anticompetitive impact in RPM cases, establishing a rebuttable presumption that the practice is unlawful. ²

Specifically, the Chinese Supreme Court concluded that antitrust enforcers are entitled to a presumption of anticompetitive impact, even though RPM may also have procompetitive effects.

It explained that because China’s markets are not perfectly competitive—and thus the country cannot rely on market forces to correct the anticompetitive consequences of RPM—China’s antitrust enforcers must be able to target potential anticompetitive effects arising from RPM arrangements. Requiring the agencies to conduct comprehensive investigations with sophisticated economic analysis in every RPM case would greatly increase costs and undermine the efficiency of agency enforcement.

At the same time, however, the court explained that RPM is not per se unlawful. Companies targeted by regulatory enforcement actions are entitled to rebut the presumption of harm in two ways. First, they can demonstrate that the RPM agreement does not actually harm competition. Alternatively, they can prove that the challenged conduct falls under an exemption to the AML, which exempts actions that promote certain public interests, including the protection of international trade or foreign economic cooperation, and the enhancement of the competitiveness of small enterprises. The opinion does not explain what types of evidence are sufficient to prevail using these rebuttals, although it is likely that companies will need to advance sophisticated legal and economic proof together with underlying evidence. And because most RPM cases will be evaluated during administrative investigations by China’s antitrust enforcer, the State Administration for Market Regulation (SAMR) may evaluate the sufficiency of a company’s proof without ever formally advancing its own. In general, it seems clear that companies should continue to approach RPM with great caution—it remains in practice one of the most serious violations of the AML—and the safest course is to avoid it.

It is also important to note that the presumption of unlawfulness in RPM cases extends only to administrative action by China’s antitrust enforcers. Private plaintiffs bringing RPM claims must still prove an anticompetitive impact resulting in actual losses to recover monetary damages.

**Abuse of Dominance.** In April 2019, SAMR fined Eastman Chemical roughly $3.6 million for abusing its dominant position in the market for alcohols used in latex paints. Eastman had entered supply agreements that obligated customers to purchase 60 to 80 percent of their annual needs from Eastman for a minimum of two to three years. SAMR considered the contracts unlawful because they limited customers’ product choices and prevented other firms from entering the alcohol market, foreclosing around 20 percent of the total market, a very low bar by the standards of other jurisdictions. But SAMR stressed that Eastman’s foreclosure deprived competitors of a sufficient number of customers to whom they could make direct sales, forcing them to rely instead on sales to intermediary dealers—who, while part of the same relevant market, have less stable demand. The decision is noteworthy because minimum purchase agreements are not explicitly mentioned in the AML. Indeed, the Eastman case appears to be the first time a minimum purchase agreement has resulted in fines, confirming SAMR’s willingness to pursue any conduct that it believes is inconsistent with the AML, whether expressly prohibited or not.  

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New Antitrust Regulations. On September 1, 2019, three regulations meant to implement China’s AML took effect: (1) the Interim Regulation Prohibiting Monopoly Agreements; (2) the Interim Regulation Prohibiting Conduct Abusing Market Positions; and (3) the Interim Regulation Preventing Conduct Abusing Administrative Rights. The regulations clarify procedural and substantive elements of the AML.

- **Monopoly Agreements (Collusion).** The first regulation covers anticompetitive agreements and other concerted practices. It makes clear that many forms of conduct—including price fixing, agreements to restrict output or production, market division agreements, agreements prohibiting competitors from purchasing new technologies and equipment, agreements prohibiting the development of new technology, and direct and indirect forms of RPM—are considered the most serious, hardcore violations of the AML. The regulation also specifies which factors SAMR will evaluate when determining whether concerted practices (what we would likely consider parallel conduct subject to the rule of reason in the United States) exist, including whether there is unity of conduct, a meeting of the minds, information exchanges, market structure, the existence of reasonable explanations for the conduct other than collusion, and the state of competition in the market, among other things.

- **Abuse of Market Position (Dominance/Monopolization).** The second regulation generally deals with single-firm conduct and clarifies how dominance is determined. Specifically, it indicates that market shares can be measured with reference to sales value, sales volume, or other data. For industries related to the Internet or intellectual property, for example, SAMR can consider business models, user numbers, network effects, foreclosure effects, data control, and countervailing buyer power when assessing market power. Importantly, the regulation also offers detail on what constitutes abusive conduct, including excessive or predatory pricing, refusal to deal, exclusive dealing, discriminatory practices, and tying.

- **Administrative Abuses (State Monopoly).** The third regulation is aimed at competition abuses by Chinese government agencies. While SAMR is not empowered to sanction other public agencies, it can issue guidance and recommendations for how to rectify offending behavior. Such abusive conduct may include restrictions on the free movement of goods, services, and investments, as well as exclusivity or exclusionary practices.

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6 Id. Arts. 7–12.
7 Id. Arts. 6, 13.
9 Id. Art. 6.
10 Id. Art. 11.
11 Id. Arts. 14–19.
13 See, e.g., id. Art. 20.
14 Id. Arts. 4–9.
**Trends in Chinese Merger Clearance.** China’s rise to antitrust prominence has given it leverage in merger reviews on a par with the United States and Europe, and it now represents a major merger control jurisdiction for companies seeking global merger clearance. With the AML now in its eleventh year—and undergoing major revisions for the first time in 2020—certain trends in Chinese merger clearance are apparent. They underscore that unconditional clearance in other jurisdictions does not mean easy success in China.

Key trends seen in 2019 include:

- **Length of Review.** Chinese merger clearance generally takes longer than in other jurisdictions, especially when potential competition concerns exist and remedies are necessary. It can be months before SAMR even “accepts” a merger filing, thereby starting a review clock that can easily run for six months, assuming the case is not on an expedited “simplified” track. In the ASE/SPIL case (2017), for example, China’s Ministry of Commerce (MOFCOM)—the relevant antitrust regulator at the time—accepted the case roughly four months after the parties filed their initial notification. It then took almost a year for MOFCOM to complete its review and approve the transaction with remedies. Other cases in which SAMR required remedies are similarly lengthy. Indeed, each conditional clearance in 2019 took well over six months.

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15 On January 2, 2020, SAMR introduced draft amendments to the AML, including a significant increase in fines for gun jumping, failure to notify, and breach of restrictive conditions; new powers allowing SAMR to update merger control thresholds from time to time; and new tolling standards that will allow SAMR to suspend the merger clearance clock if parties submit new documents or data, among other things.

On January 7, 2020, SAMR also issued new proposed merger control regulations, which are intended to streamline merger clearance reviews, clarify procedures, and consolidate a number of existing merger rules and regulations. Notable proposed rules include stricter divestiture requirements and a higher bar for certain forms of simple case reviews.


- **Behavioral Remedies.** While regulators in the U.S. and EU—in the past, at least—have expressed a preference for structural remedies, which require the parties to divest or otherwise modify their assets before a transaction is cleared, China regularly utilizes behavioral remedies, which can influence the parties' post-transaction operations. Examples of Chinese behavioral remedies include (1) supply and price commitments for Chinese (or indeed global) markets; (2) continued product interoperability; (3) licensing of standard essential patents on fair, reasonable, and non-discriminatory terms; (4) bundling prohibitions; and (5) guaranteed access to and use of technology or digital platforms. These behavioral remedies allow SAMR to address competition concerns and achieve industrial policy objectives.

- **Hold Separates.** A quasi-behavioral remedy unique to China and employed with some regularity (particularly recently), even when no other antitrust regulator imposes conditions, is a "hold separate." Hold separates can prohibit operational integration of certain business units until years after the deal closes, thereby aiming to ensure continued competition in the relevant product market. In some instances, SAMR must approve integration at the end of the hold-separate term, which generally runs between two and three years but can stretch as long as five years. Recent examples include the Cargotec/TTS (2019; two-year term), II-VI/Finisar (2019; three-year term), and Zhejiang Garden Biochemical/Royal DSM (2019; five-year term) transactions. There have been a total of eight hold-separate remedies over the last eleven years, with three in 2019 alone, which may signal an increased reliance on the remedy going forward.

- **Stakeholder Interests.** In analyzing mergers, SAMR turns to and relies on the input of various stakeholders, including customers, competitors, trade associations, and a range of government agencies and decision makers to perhaps an even greater extent than regulators in the U.S.

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18 See supra note 17 for details.
and EU. While merging parties can attempt to preempt negative feedback by engaging with customers and trade associations, and by arguing there are no anticompetitive effects, SAMR often sides with stakeholder feedback and looks for remedies that satisfy the concerns of stakeholders (including where the concerns are not well grounded in any theory of anticompetitive harm).

- **Mergers Between Chinese State-Owned Enterprises.** In October 2019, the Chinese government approved the merger between China Shipbuilding Industry Corp. (CSIC) and China State Shipbuilding Corp. (CSSC), both state-owned enterprises and the largest shipbuilding companies in China. The merger is notable because China formed CSIC in 1999 by spinning it off of CSSC. At the time, the government was seeking to stimulate domestic competition. Now, the government’s focus seems to have shifted to creating huge “national champion” companies (a trend that can only be expected to continue in the post COVID-19 world). Indeed, the combined firm is now the world’s second-largest shipbuilder. The CSIC-CSSC merger continues a trend of mega mergers between China’s state-owned enterprises, including those between (1) CNR and CSR, which resulted in the world’s largest train maker; (2) China Ocean Shipping Company and China Shipping Group, which resulted in the world’s largest shipping fleet; and (3) ChemChina and Sinochem, which will result in the world’s largest industrial chemicals firm.

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**New Controls of Market Behavior**

**China’s New Social Credit System.** For years, China has been working toward the implementation of a Social Credit System (SCS), through which it intends to monitor, influence, and publicly report companies’ compliance with laws and other government requirements. Low ratings would lead to severe sanctions, curtailing a company’s ability to operate effectively in the country. This possibility is noteworthy today because China is aiming for a complete roll out of the SCS by the end of 2020. Once fully implemented, the SCS is likely to increase the importance (and burdens) of compliance and reporting efforts.

The SCS is intended to promote integrity and credibility in the Chinese economy, but also to enhance China’s soft power, international influence, and control over market behavior. The rollout

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of the SCS coincides with a relative opening up of the Chinese market, including relaxation of joint venture and investment requirements, as discussed further below. Some observers suggest that the SCS is the reason for this opening up, providing the government with another means to influence market behavior.\(^{25}\)

The SCS aims to centralize every company’s compliance with Chinese laws, regulations, and government requirements, no matter which Chinese agency is responsible for monitoring and enforcing the relevant provision. To simplify a bit, government authorities set topic-specific requirements—generally market rules and regulations—that firms must satisfy in order to receive a good rating. Companies are then monitored for compliance through self-reported data, traditional government inspections, next-generation technologies related to big data and artificial intelligence, and third-party input from companies like Alibaba and Tencent. Based on that information, companies are rated for compliance with each set of topic-specific requirements, and the collection of ratings is centralized and accessible across agencies.\(^{26}\)

Companies that breach a government requirement will receive a rating downgrade and, over time, will experience greater restrictions on their business activities. If negative ratings accumulate, or in the event of serious misbehavior, a firm can even be blacklisted. In that situation, the SCS imposes joint sanctions. This means that the company not only could be subject to sanctions from SAMR under the AML, but could also be subject to restrictions and negative treatment from all other government agencies, including the loss of preferential tax treatment or financial subsidies, restrictions on government procurement and bidding activities, or more frequent government inspections, audits, and supervision, among other things. There are dozens of memorandums of understanding between government authorities intended to facilitate joint sanctions, as well as individual agency regulations explaining how they will report violations of relevant laws, as discussed at greater length below.\(^{27}\)

While the SCS is principally intended to help implement and enforce existing laws and regulations—underscoring the importance of robust compliance and reporting mechanisms—it can also impose new requirements. Companies may, for example, be negatively impacted by the behavior of business partners, requiring careful selection and monitoring of suppliers and distributors. Requirements related to continuing supply to Chinese customers during the U.S.-China trade dispute may also play a role, potentially putting multinational companies in a tough situation.

**SAMR Regulations Add Teeth to the Social Credit System.** On July 10, 2019, SAMR issued draft regulations entitled “Administrative Measures for Lists of Parties with Seriously Illegal and Dishonest Acts.”\(^{28}\) The regulations are meant to support the SCS and enhance social supervision, increase the consequences for unlawful actions, and publicize misbehavior.\(^{29}\) Specifically, the regulations contain a lengthy list of actions that result in inclusion on a serious offender list, ranging

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26 Id. at 10–19.

27 Id.


29 Id. Arts. 1 & 2.

30 Id. Art. 6(1)–(36).
from failure to execute an administrative sanction to repeat trademark infringement. Notably, companies that engage in unfair competition or monopolistic practices—and which cause serious harm as a result—will be included. So will companies that are found to endanger China’s national interests, or the interests of Chinese consumers, by engaging in collusion or fraud, among other things. Such provisions arguably could be used as a lever in the ongoing trade dispute between China and the United States.

Inclusion on SAMR’s serious offender list will carry several important consequences. Companies will be impacted when seeking to register and secure licenses or certifications. They will be considered a high credit risk under the SCS, becoming the object of increased regulatory attention, additional supervision, and more frequent inspections. And listed entities may experience harsher administrative punishments for future violations. If an entity voluntarily corrects its illegal behavior and eliminates any adverse impact from its actions, it can apply for removal from the list after one year. Alternatively, if the listed entity does not commit any further acts that would qualify for listing, it can apply for removal after three years. A party included on the serious offender list can also seek administrative reconsideration or institute administrative proceedings.

Trade and Foreign Investment Developments Likely to Impact Competition

China’s Unreliable Entities List. It was a year for lists. Similar to the SCS and SAMR’s serious offender list, China is creating a separate “Unreliable Entities List,” which will name any enterprise, organization, or individual that damages the interests of Chinese companies or threatens China’s national security. The Unreliable Entities List appears to be a response to the May 16, 2019, addition of Huawei and several affiliates to the United States’ “Entity List,” which is maintained by the U.S. Department of Commerce’s Bureau of Industry and Security (BIS). The effect of Huawei’s addition to the Entity List was dramatic: U.S. and non-U.S. persons that handle U.S. origin goods are prohibited from supplying to Huawei such goods or any other items subject to the Export Administration Regulation. This measure impacts suppliers’ sales to Huawei and the development of new products and technology for Huawei.

The stated reason for the BIS measure is that Huawei has been involved in activities determined to be contrary to the national security and foreign policy interests of the United States, including alleged sales of U.S. goods to Iran. Similar considerations led BIS to add ZTE, another large Chinese technology company, to the U.S. Entity List in 2016. Unlike ZTE, however, there is currently no indication or any upcoming settlement of the pending Huawei enforcement matter.

31 Id. Art. 6(18).
32 Id. Art. 6(20).
33 Id. Art. 14.
34 Id. Art. 18.
35 Id. Art. 9.
36 Id. Arts. 11–13.
39 The United States granted a temporary general license covering specified activities, including the continued operation of existing networks and equipment, support for existing consumer electronic devices, and cybersecurity research and vulnerability disclosure, among other things. 15 C.F.R. § 744, Supp. 7 (2020).
40 Addition of Entities to the Entity List, supra note 37, at 22,961–62.
In a tit-for-tat move, on May 31, 2019, China’s MOFCOM announced the creation of its own Unreliable Entities List aimed at combating “unilateralism,” “trade protectionism,” and discriminatory actions meant to block supplies to Chinese enterprises. Although MOFCOM did not explain the penalties or procedures governing the list, or which entities and individuals would be included, the Ministry announced that the list will cover foreign entities or individuals “that do not comply with market rules, violate contracts, block or cut supplies to Chinese firms [for] non-commercial purposes, and seriously damage the legitimate rights and interests of Chinese enterprises.”

Government commentary following the initial announcement suggests that companies included on the list “will be restricted in terms of sales, investments and business licenses,” while “relevant individuals” will see “their travel, activities and employment in China” “rejected.” At a minimum, MOFCOM can be expected to warn the Chinese public against doing business with entities designated as “unreliable.”

The Unreliable Entities List and its attendant policies will be based on principles taken from China’s Foreign Trade Law, the AML, and the National Security Law, among others. MOFCOM seems particularly concerned with national security, but this is an expansive notion including economic development, technological progress, and resource security. MOFCOM also views the list as a means to protect international trade rules, supply chain stability, and the global economy.

While details are still emerging, it seems likely that companies with operations in both the United States and China will need to navigate compliance with U.S. export control and trade restrictions as well as China’s requirements of continued supply. Failure to comply with China’s requirements of continued supply may result in an inability to conduct business in China, enforcement pursuant to the AML, and implications for merger review. Failure to comply with U.S. restrictions, where applicable, exposes U.S. and non-U.S. companies to potential criminal or civil fines, the most draconian of which is to suffer the same fate as Huawei—losing export privileges and the ability to procure U.S. goods. Together, actions by both China and the United States could escalate trade tension and threaten to pull apart the supply chains currently linking the two economies.

Against the backdrop of the still-simmering U.S.-China trade dispute, China has promised a more open market, a more level playing field, and a more predictable business environment. A number of new measures, most coming into effect in January 2020, reflect this commitment.

First, on October 22, 2019, China issued Regulations on the Optimization of the Business Environment, intended to create a “stable, fair, transparent, and predictable” business environment. The regulations, which came into effect on January 1, 2020, reiterate China’s commitment to equal treatment for foreign-invested firms, increased protection for intellectual property rights, streamlined administrative approvals, and enhanced antitrust enforcement against all types of...
anticompetitive conduct, among other things. While the regulations generally do not offer detail about how these principles will be achieved—calling on government at all levels to improve or establish policies and mechanisms—they do indicate that firms can submit complaints directly to China’s State Council, the country’s chief administrative authority, if government rules do not comply with applicable standards of fair competition.47

Second, China’s new Foreign Investment Law, which also took effect on January 1, 2020, streamlines and consolidates the country’s foreign investment regime and attempts to make China a more welcoming destination for investment, with better protections for foreign entities and standardized management of their investments.48 In many industries, foreign-invested enterprises will be treated just like domestic entities when it comes to market access, standard setting, government procurement projects, and technological cooperation, among other things.49 The law also aims to protect foreign investors from forced technology transfers, the exploitation of trade secrets, and the expropriation of investments.50

Third, China liberalized its other foreign investment restrictions. Each year, China issues two lists: one identifies sectors in which foreign investment is prohibited or heavily restricted, referred to as the “negative list”; the other identifies sectors in which foreign investment is encouraged, often through tax, tariff, or land use incentives. The 2019 lists reflect an easing on foreign investments in several industries, including the agriculture, mining, oil and gas, infrastructure, transportation, entertainment, telecommunications, and manufacturing industries, all of which saw restrictions come off the negative list.51 That list now covers 40 sectors, down from 48 in 2018.52 At the same time, the encouraged industries list added dozens of new sectors in which China hopes to bolster foreign investment.53 Many of those sectors relate to manufacturing, with a particular emphasis on high-technology industries like 5G components, cloud computing, aerospace materials, and artificial intelligence.

Finally, China has relaxed its joint venture requirements, which have traditionally required foreign firms to form a joint venture before they can access the Chinese market, often with a local partner owning a majority of the venture. According to reports, South Korean carmaker Hyundai is acquiring full ownership of one of its car making operations in China, buying the shares of its

47 See, e.g., id. Arts. 4–8, 62.
49 Id. Arts. 4, 15–16.
50 Id. Arts. 20–27.
Chinese partner.\textsuperscript{54} JP Morgan also won a bid that would allow it to take a majority stake in its asset management joint venture.\textsuperscript{55} And PayPal recently secured approval to acquire 70 percent of GoPay, making GoPay the first foreign-invested payment platform in China.\textsuperscript{56}

**Conclusion**

As China’s AML continues to mature, courts are grappling with novel applications of its provisions and SAMR is working to clarify its scope and meaning. Those efforts alone are noteworthy, but the fact that they are occurring against the backdrop of the ongoing U.S.-China trade war—which continues to simmer despite the countries’ Phase I agreement—and at the same time as China is revolutionizing the manner in which it monitors competition and grants access to its markets, made 2019 a watershed year. Foreign companies have more protections and greater clarity than ever, but gains remain relative. These companies continue to face many uncertainties and challenges, requiring robust compliance efforts and close attention to developments in China. 2020 promises to be equally unpredictable, with proposals for major revisions to the AML already announced and the COVID-19 outbreak upending, and in many cases paralyzing, business and government functions around the world. Be sure to stay tuned.

