SLAUGHTER AND MAY/

CLIENT BRIEFING

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CONTINUED FOCUS ON TECH:

CHINA'S FIRST MERGER PROHIBITION IN THE DIGITAL SPACE (AND MORE GUN-JUMPING DECISIONS)

In another example of China's increasing scrutiny over the digital sector, on 10 July 2021 the State Administration for Market Regulation (**SAMR**) prohibited the proposed merger between HUYA Inc. (**Huya**) and DouYu International Holdings Limited (**DouYu**). Both companies operate game live streaming platforms in China and are backed by Chinese internet giant Tencent. While this is China's third merger prohibition decision since the inception of the merger control regime in 2008, it is the first time China has prohibited a merger between domestic companies in the technology sector. We examine in this article some of the noteworthy features of what is yet another milestone in China's antitrust enforcement history.

The merger

Huya and DouYu are two leading game live streaming platforms in China with a combined market share of at least 60 percent in the domestic game live streaming market. Before the merger, Huya was already solely controlled by Tencent; and DouYu was jointly controlled by Tencent and DouYu's founder team. If the merger had gone through, Tencent (as the ultimate parent) would have moved from a situation of joint control to sole control over DouYu.

Horizontal and vertical effects

SAMR assessed not only horizontal overlaps but also the vertical relationships the proposed merger would give rise to. This is the first time a Chinese antitrust authority has analysed vertical effects in a prohibition decision.

- **Horizontal effects** - In view of the merged entity's combined market share of at least 60 percent in the game live streaming market and the high entry barrier, SAMR concluded the merger would restrict or eliminate competition in the game live streaming market, strengthening the dominance of Tencent (through its control of the merged entity) post-merger.

- **Vertical effects** - Upstream of the game live streaming market is the online game operation services market, in which Tencent is the largest player with an over 40% market share. In the prohibition decision, SAMR analysed two vertical theories of harm, summarised as follows:

    a) **Input foreclosure** - Tencent, as an online game operation services provider, owns online game copyright licenses, which SAMR considered a critical input for the downstream market for game live streaming. Post-merger, SAMR found that Tencent would have the ability and incentive to foreclose downstream competitors by blocking their access to such licenses, thereby restricting or excluding competition in the downstream market for game live streaming.

    b) **Promotion channel foreclosure** - Game live streaming provides a vital channel of promotion for the games of online game operation services providers. Post-merger, SAMR was of the view that Tencent would have the ability and incentive to use its downstream market power to deny its upstream competitors from having the necessary channels to promote their games (through live streaming), thereby restricting or excluding competition in the upstream market for online game operation services.

Not satisfied with any of the multiple remedies packages proposed to address these anticompetitive effects, SAMR ultimately blocked the merger after a relatively short review period of less than eight months. By comparison, it took SAMR an average of 10 months to accept commitments in 2020 and 13 months in 2019.

First prohibition involving domestic companies in the digital sector

There have been many mergers in the digital sector in China, so the *Huya/DouYu* case is remarkable in that it is the first time that a merger concerning this sector has been blocked, and it is the first prohibition involving domestic companies only.

One reason for the sea change is that mergers between Chinese tech companies were previously rarely (if ever) notified to or scrutinised by the authority in the first place. The adoption of the 'variable interest entity' (**VIE**) structure by Chinese internet companies, including Huya, DouYu and Tencent, was believed to have made their merger filings 'unacceptable' to SAMR, but this all changed in late 2020 when SAMR announced that VIE deals were subject to China's merger filing rules as with any other deal.[1]

The *Huya/DouYu* merger was filed on 16 Nov 2020 and therefore one of the earlier deals involving VIE companies to be notified to the authority. Prohibiting it marks another milestone in SAMR's effort to regulate the digital sector, which has been under the regulatory spotlight since late 2020.[2]

Third prohibition to date

The *Huya/DouYu* prohibition is the third time China's antitrust authority has prohibited a proposed transaction, since the inception of the merger control regime in 2008.

In March 2009, the Ministry of Commerce (**MOFCOM**), China's then competent authority, **prohibited** Coca-Cola's proposed US$2.4 billion bid for Chinese fruit-juice maker Huiyuan. In June 2014, MOFCOM issued its second prohibition **decision**, blocking a proposed operational joint venture, known as the P3 Network, by three large global shipping companies.

Compared with the European Commission, which prohibited 10 deals over the same period, it would appear that SAMR is taking a more cautious approach towards blocking deals, which could be argued to make this recent decision all the more significant.

Implications for the future

The *Huya/DouYu* prohibition should not be interpreted as a signal that SAMR is no longer willing to clear deals in the digital space. A few days before this prohibition decision, on 7 July 2021, Tencent was fined for not filing its 2013 acquisition of a 36.5% stake in China's search engine giant Sogou,[3] but six days later, on 13 July, SAMR published its unconditional approval of Tencent's more recent plan to take over the same company Sogou (now US-listed).

It is also noteworthy that although many previously un-notified mergers involving the VIE structure were notified to and fined as gun-jumping cases by SAMR in recent months,[4] the *Huya/DouYu* merger is the first tech merger in which SAMR has identified serious competition concerns warranting a prohibition.

Finally, where a tech deal does raise competition concerns, it appears that SAMR remains open to behavioural remedies. On 24 July 2021, SAMR **issued** a gun-jumping decision, again against Tencent for its 2016 acquisition of China Music Corporation. It is the first published gun-jumping decision in which SAMR has identified competition concerns. However, instead of requesting that the parties unwind the completed transaction (which is within SAMR's power to do), SAMR imposed behavioural remedies on Tencent, including requiring Tencent to relinquish its exclusive music rights, waive the preferential terms it has with music copyright holders, and refrain from making high advance payments to music copyright holders to drive up competitors' costs, etc.

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[1] See our previous **client briefing** on SAMR's policy clarification on deals involving the VIE structure in December 2020.

[2] For example, see our previous client briefings on the **record-breaking antitrust fine levied against Alibaba**, and **China's first antitrust guidelines for internet platforms**, as well as the **newsletter** on the investigation into Meituan (an influential online food delivery platform in China).

[3] See the **22 gun jumping decisions** published by SAMR on 7 July 2021, in which Tencent was fined for acquiring 36.5% shares in Sogou in 2013 without notifying the deal to China's antitrust authority.

[4] SAMR expressly required un-notified VIE deals, which had met the filing threshold, to be reported to them in December 2020, as explained in our previous **client briefing**.

Conclusion

The *Huya/DouYu* prohibition decision is a timely reminder that China's digital sector continues to be high on the regulatory agenda. Prohibiting a merger in the digital space for the first time also sends a powerful message that going forward, SAMR will closely scrutinise transactions in the digital economy under China's merger control rules. However, the importance of the prohibition should not be overstated, as SAMR is expected to assess each case on its own merits and make decisions on a case-by-case basis.

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