

Getting Ready for the Revamped Merger Control Regime in China

CHINA

BACKGROUND

In China, like in the EU and the US, the merger control clearance has potentially been a key milestone for cross-border mergers, acquisitions and joint venture establishments. Since a concentration of business operators may lead to concentration of market power, business operators must obtain merger control clearance from China's antitrust agency, the State Administration for Market Regulation (the "SAMR") in relation to their proposed "concentration"¹ if the notification thresholds are met.

When an M&A or Joint Venture project is a notifiable transaction, the legal consequences of failure to report may be more than just an administrative fine. For example, Tencent Holdings Ltd., a Chinese multinational entertainment conglomerate, failed to report its acquisition of 61.64% of the shares in China Music Corporation in 2016 to SAMR for prior clearance. Tencent was ordered by SAMR in 2021 to take necessary measures to restore its pre-concentration status.

UPDATES TO THE AMENDED MERGER CONTROL REGIME

On June 24, 2022, the Standing Committee of the National People's Congress of China adopted the amendments to the China's Anti-Monopoly Law (the "Amended AML") after a two-year public consultation and review. This was the first amendment to the Anti-Monopoly Law since its promulgation in 2008. The Amended AML became effective on August 1, 2022.

To provide clarification on the Amended AML, the SAMR published on June 27, 2022 the draft *Implementation Rules on Merger Control Filing Threshold and the Provisions of Merger Control Review* (the "Drafts").

The Amended AML and the Drafts proposed significant changes to the merger control regime in China. Below we set out the key changes to the existing merger control regime in China:

- *Turnover Thresholds Increase*

In China, turnover thresholds to trigger a filing in China were set in 2008 when the Anti-Monopoly Law was promulgated. Since then, the thresholds have remained unchanged. To accurately reflect the economic growth in China in the last decade, the Drafts proposed to revise the merger notification thresholds by raising the existing notification thresholds.

Existing Thresholds	Proposed New Thresholds
1. The business operators concerned combined worldwide turnover is RMB 10 billion, or combined PRC turnover is > RMB 2 billion; and	1. The combined worldwide turnover of business operators concerned is RMB 12 billion, or combined PRC turnover is > RMB 4 billion; and
2. Each of two business operators concerned has PRC turnover > RMB 400 million	2. Each of two business operators concerned has PRC turnover > RMB 800 Million

1. A concentration under the < *China's Anti-Monopoly Law* > is defined as: (a) a merger; (b) an acquisition of control of another party through an asset or equity acquisition; and (c) a possession of control or «decisive influence» over another party, by contract or otherwise.

If the changes to the turnover threshold are accepted in the final version of the Drafts, it may conceivably result in fewer notifiable transactions and small enterprises with low turnover could be relieved from the notification obligation. SAMR's current burden may be lessened as well.

- **Notification Obligations on Killer Acquisitions**

The acquisition of small or medium sized competitors by existing corporate giants or so called 'killer acquisitions' have become a hot topic globally (e.g. Facebook's acquisition of Whatsapp, Google's acquisition of Motorola Mobility). They have attracted the attention of merger control in many jurisdictions.

To address these concerns, the New Amended AML enables the SAMR to review and intervene in the 'killer acquisitions' that do not meet the turnover thresholds as set forth in the above Turnover Thresholds Increase section. Specifically, if one business operator's annual turnover in China exceeds RMB100 billion, and the other business operator(s)'s market valuation or market evaluation exceeds RMB800 million and its revenue in China exceeds one-third of its global turnover, a concentration of business operators must be filed with the SAMR for approval.

However, it remains to be seen how the above test will be implemented in practice as the determination of the market value of a business operator to the concentration can be subject to reasonable arguments.

- **Priority Sectors for Merger Control Review**

The Amended AML adds a provision mandating SAMR to strengthen its scrutiny of deals related to national interests and people's livelihood.

Finance, media, technology, start-ups, new business models or labor-intensive industries could be amongst the priority sectors subject to strict scrutiny, as these sectors are specifically highlighted as areas for strengthened merger control review in the <State Council's Opinion on Accelerating the Building of a Unified and Nationwide Market> published in April 2022.

- **"Stop-the-clock" Mechanism**

Under the current regime, the SAMR has a period of up to 180 days to clear a merger filing. A merger review process normally involves the following stages.

Stage	Duration	Note
Preparation of filing materials	Case-specific	The timing varies depending on the number of relevant markets, the timeline and completeness of relevant parties' responses to information requests
Phase I review	30 days	Most simple cases are cleared within this stage
Phase II review	90 days	Most normal cases are cleared within this stage
Extended Phase II review	60 days	This is usually only for cases with complex issues or significant competition concerns

Under the Drafts, the “stop-the-clock” mechanism suspends the merger review process and provides SAMR additional time to review a transaction, if:

- (1) the notifying parties fail to provide requested information or materials;
- (2) new circumstances or facts that materially impact the review arise; or
- (3) at the notifying parties’ request the proposed remedies require further assessment.

This “stop-the-clock” mechanism can provide SAMR with more time when reviewing complex merger cases, in particular those involving remedy negotiations. In some cases, the SAMR may suggest or indicate that it expects certain remedial conditions that the parties are not yet ready to accept, particularly if the Extended Phase II review period is about to expire. In that situation, if the parties wish to keep negotiations with the SAMR open, they can voluntarily withdraw their application on certain technical grounds, and immediately resubmit it, starting again at Phase I review. As such, the “stop-the-clock” mechanism largely eliminates the need for companies with complex transactions to pull and re-file if the review extended beyond the prior 180-day time limit. However, the “stop-the-clock” mechanism may result in uncertainty for less complex cases.

- ***Higher Penalties for Violations***

Under the Amended AML, if merging parties fail to notify SAMR of a notifiable transaction or otherwise engage in gun-jumping, the fine will be increased from RMB 500,000 to RMB 5 million for deals that do not harm competition. For mergers with anticompetitive effects, the fine is set at a maximum of 10% of the infringing party’s turnover in the prior year.

The Amended AML also indicates that AML sanctions could be recorded in the infringing company’s social credit system. As the government is continuing to take measures to build and improve the social credit system, the power to publish social credit records will pose reputational risks for companies.

The Amended AML opens up, for the first time, the possibility of criminal liability where the antitrust infringement constitutes a crime. Currently, antitrust violations are not criminal offences in China except that obstructing an investigation may amount to a crime under *<Chinese Criminal Law>*. The Amended AML does not create new criminal offences, but it suggests that the Chinese government is contemplating the introduction of criminal sanctions for antitrust violations. This would require subsequent amendments to *<Chinese Criminal Law>*.

PRACTICAL EFFECTS AND RECOMMENDATION

As the financial costs for gun-jumping have significantly increased, parties should carefully assess the notifiability of their JV establishment, acquisition or merger transactions going forward – particularly for cases that may give rise to competition concerns, as the fines have increased exponentially from RMB 500,000 to a maximum 10% of the relevant parties’ turnover in the last financial year.

Moreover, given the “stop the clock” mechanism may cause uncertainty on timing, businesses are recommended to take special care when planning transaction timelines if the merger control clearance is required.



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