

China Amends Rules for Merger Control Filing and Review

China is implementing multiple changes to its merger control procedures, following recent amendments to the country's Anti-Monopoly Law.

Key Points:

- **New Jurisdictional Rules and Reporting Thresholds**
 - China's competition agency (SAMR) is establishing procedures for investigating transactions that fall below the country's mandatory notification thresholds.
 - China is updating its turnover thresholds and adding a new alternative threshold that considers the target's "market value" and the portion of sales that the target earns in China.
- **Revised Review Procedures**
 - China has introduced a new mechanism to "stop the clock" during merger reviews, potentially impacting merger review timelines.
 - SAMR will delegate simplified-procedure case reviews to local offices under a new "classified and graded" system of delegating merger review work.
- **Greater Consequences for Violations**
 - China has increased fines for failure-to-file/gun-jumping for undertakings and individuals.
 - For aggravated circumstances, China can now impose fines two to five times the initial amount.

China's Standing Committee of the National People's Congress has amended the country's 14-year-old Anti-Monopoly Law, effective August 1, 2022 (the Amended AML). China's antitrust authority, the State Administration for Market Regulation (SAMR), has published draft "implementation regulations" that, once finalized, will put these amendments into effect.¹ These amendments and implementation regulations include a number of important changes to China's merger control thresholds, procedures, and failure-to-comply penalties.

This Client Alert sets out the key changes to China's merger control rules and offers best estimates of when the rule changes will become effective. However, SAMR's draft implementation regulations remain subject to change as they are finalized. Parties whose merger control strategies in China could be impacted by the timing of these rule changes should confer with their antitrust team as needed.

New Procedures for Reviewing “Below-Threshold” Transactions

(Effective August 2022)

The Amended AML formally authorizes SAMR to “call in” a transaction and require notification if there is evidence that the concentration may eliminate or restrict competition, even if the transaction does not meet SAMR’s mandatory notification thresholds. Prior implementation regulations under the original AML indicated that SAMR had the power to intervene to investigate non-reportable transactions, but SAMR had not defined a mechanism for doing so, and the process was little used in practice.² With the Amended AML and accompanying implementation regulations, SAMR is establishing more formal procedures that enable it to call in transactions that do not trigger mandatory filings.

In particular, under SAMR’s draft Merger Review Rules (expected to be finalized in August 2022):

- SAMR may contact parties and instruct them to file a notification for a transaction if it believes there is evidence that the concentration may eliminate or restrict competition.
- If the concentration *has not already closed*, then once SAMR calls in the transaction, the parties cannot close the transaction until they obtain clearance from SAMR.
- If the concentration *has already closed*, SAMR can require the parties to cease implementation of the transaction or take other measures necessary to restore competition.

The draft Merger Review Rules do not provide more specific guidance about what types of transactions SAMR is likely to call in. However, SAMR likely will focus on using this new authority on “killer acquisitions” in which incumbent firms acquire innovative targets or nascent competitors, thereby preempting the emergence of future competition.³ To be clear, the implementation regulations do not limit SAMR to calling in killer acquisitions — *any* concentration that SAMR deems to have the potential to eliminate or restrict competition is exposed to the risk of being called in under these procedures.

This expansion of SAMR’s authority is consistent with developments in other jurisdictions. The European Union, for example, recently affirmed the authority of the European Commission to call in and review non-reportable transactions under Article 22 of the EU Merger Regulations.

For parties pursuing concentrations with a nexus to China, these new rules mean that the China merger control analysis must go beyond the question of whether a mandatory filing is triggered. Going forward, parties to a concentration that falls below China’s mandatory filing thresholds should assess the risk of being called in by SAMR. Factors to consider in this analysis include the prominence of the transaction (both globally and in China); whether the local stakeholders (e.g., Chinese customers and competitors) may raise concerns about the transaction; whether the transaction may limit the number of suppliers or sources for related products to the Chinese industry; the concentration levels in the effected markets; and SAMR’s prior experience and focus on the sector.

Parties that conclude that their transaction bears some risk of being called in” by SAMR should carefully consider how to allocate those risks in their transaction agreement, including how to structure their closing conditions to address the potential situation. Parties that pursue transactions with a nexus to China should also monitor this space for further developments, trends, and guidance on what types of transactions tend to be called in by SAMR for further review.⁴

Amendments to the Filing Thresholds

(Implementation regulations are in draft form; final text expected by end of 2022)

China is preparing to revise its merger control thresholds, including by (1) raising its existing turnover thresholds and (2) introducing a new “market value” and “turnover ratio” threshold that will capture transactions beyond what is captured today.

Presently, parties to a transaction must make a merger control filing in China if (1) the individual Chinese turnover of at least two undertakings exceeds CNY 400 million (2021: approx. US\$62 million) in the preceding financial year and (2) the combined turnover of all undertakings exceeds CNY 10 billion (2021: approx. US\$1.55 billion) on a global basis and/or CNY 2 billion (2021: approx. US\$310 million) within China.

SAMR’s draft Notification Thresholds Rules will amend China’s mandatory notification thresholds as follows:

- a) **Turnover threshold:** A filing will be triggered in China if (1) the individual Chinese turnover of at least two undertakings exceeds CNY 800 million (2021: approx. US\$124 million) in the preceding financial year and (2) the combined turnover of all undertakings exceeds CNY 12 billion (2021: approx. US\$1.86 billion) on a global basis and/or CNY 4 billion (2021: approx. US\$620 million) within China.
- b) **“Market value” and “turnover ratio” thresholds:** If the above turnover threshold is not met, the transaction will still be notifiable to SAMR if the following conditions are present:
 - The turnover of one of the undertakings in the concentration exceeded CNY 100 billion (2021: approx. US\$15.5 billion) in China in the previous financial year; AND
 - The market value (or valuation) of the other undertaking in the concentration is no less than CNY 800 million (2021: approx. US\$124 million), and its turnover in China in the previous financial year shall account for more than one-third of its worldwide turnover.

SAMR is in the process of finalizing the Notification Thresholds Rules that will implement these new thresholds. Among other things, SAMR is discussing the “market value” test with relevant stakeholders and evaluating whether to provide further guidance on how market value will be established (and by what institution) for purposes of implementing these rules. SAMR is likely to finalize and release the final form of these revised thresholds by the end of 2022.

The forthcoming increased turnover threshold reflects SAMR’s long-standing plan to reduce the number of notifiable transactions it receives and to focus on those transactions that are more capable of affecting the Chinese market. At the same time, SAMR’s introduction of the “market value” and “turnover ratio” threshold standards is consistent with developments in other jurisdictions, as antitrust enforcers around the globe focus on transactions involving large-scale companies and companies that have significant value but have not yet generated significant revenues, such as startups.

Introduction of “Stop the Clock” Mechanisms

(Effective August 1, 2022)

Under the newly added Article 32, the Amended AML introduces a “stop the clock” mechanism that allows SAMR to suspend a merger review if any of the following conditions are met:

- **Delayed or incomplete documentation:** Filing parties fail to submit requested supporting documents and materials;
- **Changed circumstances:** New circumstances or new facts that materially impact the review occur and need to be verified; or
- **Remedy proposals:** The parties request a stop clock to allow SAMR to review new or modified remedy proposals.

SAMR will resume its review as soon as the interrupting factors described above are eliminated.

A stop-the-clock mechanism reflects, in part, the practical challenges that SAMR faces in reviewing complex merger filings. The original AML stipulated that the statutory review period should not exceed 180 days, upon the case initiation. In practice, 180 days often proved insufficient for normal-procedure cases that warranted comprehensive competition assessment or even negotiation of remedies, and SAMR routinely asked the parties to pull and refile their notifications to restart the clock.

With a stop-the-clock mechanism, the Amended AML provides SAMR with more timing flexibility in the review process and will hopefully end the current “pull and refile” practice. At the same time, the mechanism introduces some uncertainties for parties to a merger notification. For example, what it will take to re-start the clock, and what happens if SAMR demands information that the parties cannot practically produce? How many times can the mechanism be applied during one review, and will there be a maximum duration?

Parties are recommended to use extra caution when planning transaction timelines if a complex China review will be triggered.

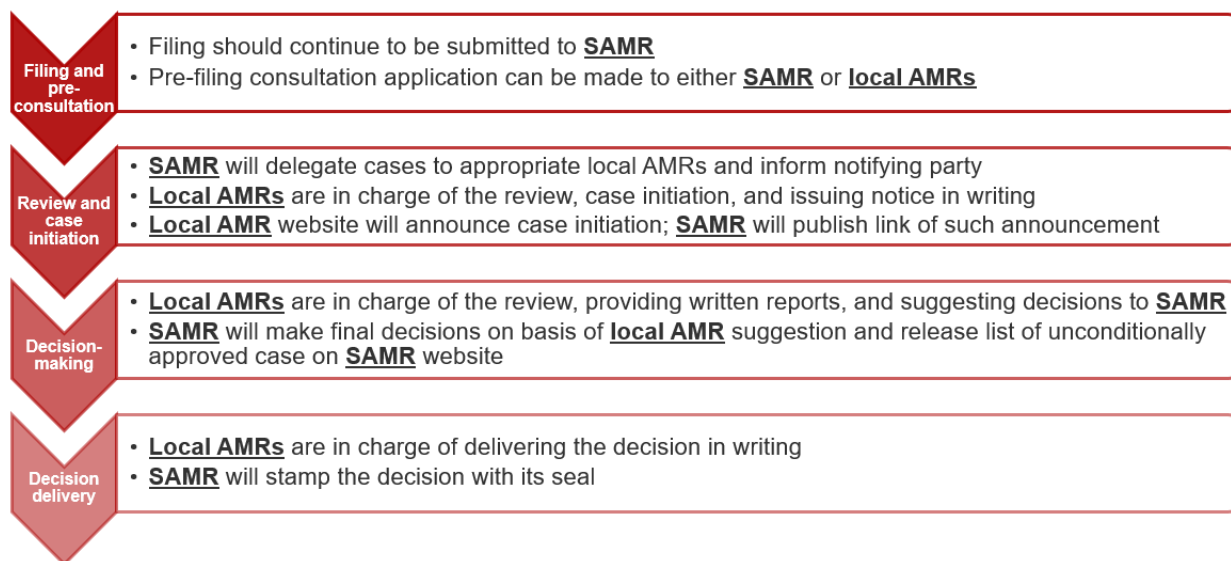
Review Procedure and Adoption of a “Classified and Graded” System

(Effective August 1, 2022)

Historically, SAMR conducted its merger control work at the central level. Following a smaller pilot program, SAMR is now introducing a pilot program with five provincial counterparts in Beijing, Shanghai, Chongqing, Shaanxi, and Guangdong (local AMRs). These local AMRs will carry out the initial review of certain simplified-procedure cases for a trial period from August 1, 2022, to July 31, 2025.

For parties undergoing merger review, this pilot program should not substantively impact the China merger review process. Parties that have filed with SAMR before may notice changes in some elements of the procedure, however, including the location of the case handler.

Below is the delegated review procedure under this new “classified and graded” system:



More Severe Legal Liabilities

(Effective August 1, 2022)

The Amended AML significantly increases legal liabilities for failure-to-notify and gun-jumping (i.e., if the filing parties implement the concentration without approval after notification). The major revisions are summarized below:

AML Violations	Fine Penalties in 2008 AML	Fine Penalties in Amended AML
Liabilities Related to Failure-to-Notify / Gun-jumping		
For transactions that do not lead to competition concerns	Up to CNY 0.5 million (approx. US\$74,484)	Up to CNY 5 million (approx. US\$744,844)
For transactions that eliminate/restrict competition		Up to 10% of the notifying party's group turnover in the last year
	<i>Other measures include to cease the transaction, dispose of shares or assets, transfer the business, or take other necessary measures to restore the market situation before the concentration</i>	

AML Violations		Fine Penalties in 2008 AML	Fine Penalties in Amended AML
General Penalty Provisions Across Different Antitrust Violations			
Refusing or obstructing lawful antitrust reviews and investigations	Individuals	<ul style="list-style-type: none"> Up to CNY 20,000 (approx. US\$2,979) Up to CNY 0.1 million (approx. US\$14,897) for severe acts 	Up to CNY 0.5 million (approx. US\$74,484)
Aggravated fines		N/A	If the circumstances of a violation are “particularly serious,” with “particular egregious impact” and “particular serious repercussions,” antitrust fines can be further increased by two to five times of the initial penalty amount
Credit records		N/A	Antitrust penalties upon companies will be reflected in their credit records pursuant to the relevant laws and will be announced to the public
Potential criminal liability		Potential criminal offense for obstruction of antitrust investigations only	Persons committing antitrust infringements may be held criminally accountable if the infringement constitutes a crime (beyond violations of obstruction of investigations)

For parties pursuing transactions with a nexus to China, these enhanced penalties amplify the importance of carefully considering both the parties’ initial obligations to file as well as the parties’ ongoing “standstill” obligations not to implement their transaction while the merger review is pending.

Latham & Watkins will monitor and report on developments related to the Amended AML, and will provide further updates as the new filing thresholds come into full effect.

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Endnotes

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- ¹ To provide specific guidance on the changes to the merger control rules, SAMR published drafts of two existing merger control implementation regulations for public comment: *The Rules of the State Council on the Notification Thresholds for Concentrations of Undertakings* (SAMR's draft "Notification Thresholds Rules") and *The Rules on the Review of Concentrations of Undertakings* (SAMR's draft "Merger Review Rules"). SAMR is likely to soon publish the final text of these rules to assist the implementation of the amended AML. Additionally, as part of the implementation of the "classified and graded" system, SAMR released *The Announcement on Trials of Delegated Review of Certain Concentrations of Undertakings* on July 15, 2022 (SAMR's "Delegation Program"), launching a pilot program to delegate SAMR's merger review responsibilities to five provincial arms of SAMR ("local AMRs").
 - ² The 2008 *Rules of the State Council on the Notification Thresholds for Concentrations of Undertakings* gave Chinese antitrust agencies the right to intervene in transactions that do not meet the notification thresholds, and the 2021 *Anti-Monopoly Guideline of the Anti-Monopoly Committee of the State Council on Platform Economy* further explained that SAMR had a duty to investigate transactions that do not meet the notification thresholds but that may exclude or restrict competition. These rules and guidelines did not provide a mechanism for SAMR to call transactions in, however.
 - ³ SAMR raised concerns in its 2020 annual report that some acquisitions of startups and emerging platforms could have the effect of excluding and restricting competition and, thus, fall under the scope of AML enforcement, even though they do not meet the filing threshold. Available at <https://www.samr.gov.cn/xw/zj/202109/P020210903516952588333.pdf>.
 - ⁴ Whether SAMR will adopt additional procedures beyond the Merger Review Rules to provide parties with greater certainty around whether their transaction will be called in for review is unclear. By way of comparison, under the US merger control system, the

antitrust regulators can call in a non-reportable deal at any time, and parties have no established way to get certainty from US regulators that they will *not* call in a deal. In contrast, some voluntary-filing jurisdictions like the UK have more established procedures by which parties can contact the competition authority, explain the transaction, and explain why they are not filing. Which system SAMR will follow is unclear.