The Informed Board
Fall 2022

Skadden

Demystifying China's Merger Review Process

Winning Chinese approval for a merger can seem like an opaque and puzzling process to newcomers, in part because Chinese law requires regulators to consider broad economic and policy considerations, not just the impact on competition.

China's merger clearance authority plays a critical role in global M&A, even for deals that have few obvious ties to China. Particularly in the technology area, China is often the last hurdle to clear. Moreover, unlike those in other major jurisdictions, China's competition regulator must consider the impact of a deal not only on competition but also on China's national economic interests.

Hong Kong-based partner **Drew Foster** answers some common questions about the merger clearance process in China, which can seem opaque to many, and how best to navigate it.

1 What cases have to be submitted for review?

China's Anti-Monopoly Law requires parties to submit transactions that entail a change of "control." These include mergers and acquisitions, of course, but also joint venture (JV) transactions (sometimes even when the JV has no current or planned operations in China) and certain minority investments where no party is based in China.

China's competition authority, the State Administration for Market Regulation (SAMR), interprets a change of "control" broadly and has significant discretion in directing parties to file. Even the acquisition of a minority stake may be subject to filing if it comes with board representation, important veto rights such as appointment or removal of the CEO, or approval of the annual budget or business plan.

The revenue thresholds (converted to U.S. dollars) currently are:

1. at least two parties to the transaction each has revenue of $55 million or more in mainland China, and

© Skadden, Arps, Slate, Meagher & Flom LLP. All rights reserved.

2. the parties' combined annual group revenues globally are at least $1.4 billion, or they have combined revenue of at least $277 million in mainland China.

These thresholds are under review and are likely to be increased by the end of 2022 or early 2023.

The breadth of deals that fall under the filing requirement can surprise some. Revenue is calculated at the parent level (including the entire group), and SAMR does not require any nexus to China, other than group revenues. Thus, if two American parents form a JV in the U.S. to provide services in California, and the JV does not plan to have China activities but the parents otherwise meet the China revenue thresholds, SAMR requires a filing. (The deal may be eligible for expedited review, however, as explained below.)

SAMR also has the power to investigate transactions that do not meet the filing thresholds but might otherwise negatively affect competition in China or worldwide, as SAMR determines.

2 What does China consider in its review?

SAMR will conduct conventional competition analyses, examining transactions among competitors, looking at combined market shares and evaluating the risk that the transaction will raise consumer prices or stifle innovation. It will also review vertical and conglomerate mergers where the parties are active in related but nonoverlapping markets. Here, SAMR looks at whether a combined firm could block competitors' access to important inputs, unlawfully tie sales of a "must have" product together with sales of a weaker product or gain access to sensitive information about competitors (*e.g.*, where a competitor of one party is a customer of the other).

Unlike other jurisdictions, Chinese law requires that, in addition to competition concerns, SAMR consider the impact of a transaction on the "national economic development of China," *i.e.*, whether it runs counter to China's industrial policies or domestic interests. This means that, in most ordinary merger reviews, SAMR must solicit input from and take into account the views of a wide range of Chinese stakeholders.

3 How long does the review take?

China has a fast-track "simplified procedure," and about 99% of such cases are approved within three months from the initial submission. Deals are eligible where the parties' combined market shares are below 15% and their individual shares in related markets are below 25%. Overseas JVs with no operations in China also qualify. But SAMR has full discretion to determine which deals ostensibly meeting these requirements will in fact be allowed onto this fast track.

> *"If Chinese stakeholders object to a transaction, SAMR will try to achieve a consensus on the terms of a clearance."*

All other cases will be reviewed under the ordinary procedure, which typically takes six to nine months or more, even for cases that pose no serious competition or industrial policy issues. Complex cases usually take nine to 12 months — longer if they pose particular problems for stakeholders in China. Although SAMR's statutory time frames for reviews are shorter, in practice there are no consequences for the agency when it misses its deadlines. Indeed, SAMR was recently granted the ability to stop the review clock altogether, giving it even more power to delay reviews.

SAMR will not accelerate ordinary procedure reviews unless there is extraordinary political will on the China side to do so. Usually, this only occurs where a deal brings significant, incontrovertible benefit to China.

4 Why does the review take so long?

Because SAMR must consider China's national economic interests, it cannot unilaterally approve a transaction without factoring in the views of major stakeholders. Those include not only customers but also competitors, trade associations and important government ministries. If Chinese stakeholders object to a transaction, SAMR will try to achieve a consensus on the terms of a clearance. That can take many months, especially when there are commercial or geopolitical incentives to delay or obstruct a deal and/or there are serial negotiations with stakeholders (with sometimes competing interests themselves). SAMR's outreach process to domestic stakeholders is kept confidential from the parties, which makes assessing the situation at any given time extraordinarily challenging.

Fortunately, for deals that qualify, the simplified procedure replaces this stakeholder consultation with a 10-day public comment period. If no negative comments are received in that window, SAMR usually approves the transaction within a week or two.

5 Do Chinese regulators coordinate their investigations or remedies with authorities in other jurisdictions?

In complex global transactions, SAMR commonly coordinates with other peer regulators, especially those in the European Union, U.K. and U.S. The regulators will typically coordinate on theories of harm and timing expectations, though SAMR generally does not share large numbers of documents with other regulators. Traditionally, it has preferred to see what other major regulators will do before finalizing its own approach, often by addressing China-specific interests in addition to aligning with those dealt with at the global level.

6 What are the chances China will block our deal?

Of the thousands of deals that China has reviewed, only three (less than 0.01%) have been prohibited. The overwhelming majority (99%) are cleared unconditionally. Conditions typically are imposed in only about four to 10 cases each year (less than 1%). There have also been a handful of transactions where China delayed its decision for so long that the parties abandoned the deal.

It is noteworthy that nearly all of the prohibitions, conditional approvals and abandonments over the past 10 years have occurred in the technology sectors that are important to China's national growth, such as semiconductors, automotive/aviation, and industrial equipment and supplies.

"It cannot be stressed enough that there is no silver bullet, and no single person, consultant or politician can cut short SAMR's review or consultation procedures and deliver a miraculous unconditional approval. In almost all instances, the only way through the process is through it. … ."

China has not wanted to discourage investment or create geopolitical tensions by blocking deals, but many Chinese stakeholders are adept at using the SAMR process to extract commercial benefits or delay foreign deals. The agency is also very willing to insist on China-specific remedies, even where all other global regulators have approved unconditionally.

7 What impact do current geopolitical tensions have on the SAMR review process?

Particular incidents, sanctions or legislation may cause temporary delays or reactions through SAMR, and deals in sensitive sectors are more likely to experience political delays or remedy requests. For example, the China-U.S. trade disputes of the last five years, coupled with China's determination to achieve "chip independence," have led to significant scrutiny of semiconductor and related deals. Fortunately, geopolitical tensions usually do not affect the deals that SAMR permits to be reviewed in the simplified procedure.

8 How do we maximize our chances of getting through the review process quickly and unscathed?

Advance planning is the key. Well before signing, parties must assess China's likely level of interest in a deal, identify potential Chinese stakeholders with an incentive to use SAMR's review to their advantage and scope out competitive, geopolitical and industrial policy issues that could affect a decision. There is no substitute for undertaking thorough and detailed stakeholder mapping and using that to develop an action plan for the potential challenges.

It cannot be stressed enough that there is no silver bullet, and no single person, consultant or politician who can cut short SAMR's review or consultation procedures and deliver a miraculous unconditional approval. In almost all instances, the only way through the process is through it. Nonetheless, parties should use their own China government relations teams to navigate stakeholder demands. These contacts can also be supplemented by expert local counsel who can offer insight into the SAMR process.

Finally, it is best to keep a low profile politically to minimize the odds of attracting adverse attention.

9 What id we just don't file or, if we run into trouble, close without Chinese approval?

If the filing thresholds are met, Chinese law prohibits closing any part of the deal prior to approval. SAMR will not allow the parties to hold separate the China portion of a deal while closing elsewhere or "park" China assets with a financial buyer with no China revenues in order to circumvent the filing obligation.

China recently increased the fines for gun-jumping (closing before approval) tenfold to about $700,000 for cases that do not pose issues. For a high-profile transaction raising real competition or industrial policy concerns, the fine can now be up to 10% of the acquirer's global turnover in the previous year. In addition, SAMR can, in theory, order the parties to unwind the transaction and/or revert to the status quo prior to the transaction, although that power has only been used once in China's merger review history, and that was done in a domestic combination.

Authors

Andrew L. Foster / Hong Kong

Julia Zhu / Shanghai

This article is from Skadden's *The Informed Board*.

View past editions / You can find all *Informed Board* articles here.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West / New York, NY 10001 / 212.735.3000