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Chinese Merger Control after the Big Antitrust Reform 2022

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Looking back on the year 2023, this note aims to give an update on the state of play in Chinese merger control. In particular, it looks at how merger control has evolved since China's main antitrust statute – the Anti-Monopoly Law ("**AML**") – was amended for the first time in summer 2022.

I will look at the string of important decisions by China's antitrust regulator – the State Administration for Market Regulation ("**SAMR**") – adopted over the past few months, as well as new or planned AML implementing rules in the merger control field.

At broad brush

To a large extent, the merger control developments are within the expectations generated by the AML amendment. In a way, the pre-existing dynamics have been confirmed.

Put simply, the "two tier system" has been further consolidated: on the one hand, M&A deals qualifying as "simple cases" sail through the Chinese merger control system with a breeze. There are indications that merger clearance for simple cases could become even easier and quicker going forward.

On the other hand, there are the particularly sensitive or complex transactions which need to go through a very lengthy and cumbersome procedure to obtain clearance. Recent cases show that the AML amendment has likely made it even more difficult for those transaction to obtain clearance.

Simple cases

Looking good

According to statistics from market analyst PaRR, on average around 85% of merger filings were processed through the simple case procedure from spring 2018 (when SAMR officially took over merger control powers from its predecessor authority) to the end of July 2022. The number from August 2022 onwards is even higher: around 90% of filings have been examined as simple cases.

The duration of the simple case procedure has remained relatively stable. From spring 2018 to end

of July 2022, it took around 15 days on average from case acceptance to clearance. In contrast, for the period after August 2022, the average duration was around 18 days.

These numbers only concern the time after SAMR has accepted the case on file, as no information is made public on the time from filing to case acceptance. That said, in our experience, SAMR rarely takes longer than three to four weeks for this initial phase before case acceptance for simple cases. All in all, simple cases are approved quickly, with the result that many times SAMR clearance is issued before the approval of other antitrust regulators to which the same transaction was notified.

Even the delegation of merger review powers to five select provincial offices of SAMR – in Beijing, Shanghai, Guangdong, Chongqing, and Shaanxi – in August 2022 has not slowed down approvals. For simple cases cleared since August 2022, the five provincial regulators took an average of 17.9 days, while SAMR took 18.3 days.

Admittedly, in some cases delegated to provincial authorities, the complexity of case management has increased. Short term, this is often because of the more limited merger review case-handling experience at the provincial level (relatively speaking). Longer term, this is because of the fact that key decisions in the merger review process need to be adopted in the name of SAMR, and even some detailed questions are in practice reviewed by SAMR. For difficult specific questions arising during the merger review process, the provincial case handler may consult with SAMR as well, which makes the case-handling process more complicated from a company's perspective. However, overall, as the data indicates, clearance is still quite quick in delegated cases.

This conclusion is important, as there are rumours that SAMR considers extending the delegation of merger control powers to additional provincial branches. If so, we should expect longer procedures for the simple cases delegated to new authorities, as casehandlers accumulate experience, but not necessarily significant slowdowns in the longer run.

Another positive development, following China's accession to the Hague Convention on 7 November 2023, SAMR appears to accept the submission of the "incorporation certificate" of the notifying parties with the Hague Apostille. The apostille can be obtained through a much quicker process as compared to the prior super-legalization process through the Chinese embassy or consulate in the country of incorporation (see our alert here).

In addition, reports indicate that SAMR may be exploring options to reduce the data submission burden for the parties in simple case filings, especially for transactions with very low market shares and foreign-to-foreign transactions with no impact on the China market.

More details on market definition

For simple cases, there are few signs indicating a tightening of the procedure. As an exception, SAMR may plan to require the notifying parties to include a summary of their arguments on market definition in the public notice to be posted on the website of SAMR or its provincial branches.

Complex cases

Since the AML was enacted over 15 years ago, some transactions have had to go through a very lengthy and complicated procedure. In two instances the outcome of the procedure was a prohibition decision; 67 cases were approved subject to remedies; and a (hard-to-quantify) number of transactions were abandoned due to the concerns proffered by SAMR or its predecessor authority or due to the length of the procedure.

As can be seen from the above description, in terms of numbers, the prohibition and remedies decisions make up a small percentage of transactions filed: only around 1.2% before the end of July 2022, and around 0.6% after August 2022. Therefore, the AML amendment has not brought about a significant change in the amount of the transactions which were prohibited or cleared subject to remedies.

However, the three most recent "adverse" SAMR decisions show that, for certain sensitive or other complex transactions, securing SAMR approval may have become even more difficult post-AML amendment – both from a procedural and substantive point of view.

Stop-the-clock

Procedurally, the AML amendment's biggest change in the merger review process was to introduce a "stop-the-clock" mechanism. Based on the newly added AML provision, SAMR is empowered to suspend the running of the previously automatic timeline if the merging parties agree, if they do not respond in time to a SAMR request for information, or if SAMR needs more time to consider specific remedies proposals put forward by them. While the stop-the-clock mechanism may have certain benefits, such as avoiding the situation where the merging parties would need to pull and re-file a transaction if SAMR does not have sufficient time to gather the facts to clear the transaction, it can also inject considerable uncertainty into the closing schedule as there are no clear guardrails on how the authority uses the mechanism (see our prior alert).

In the most recent public SAMR decisions, the potential for negative impact that the stop-the-clock mechanism can have is very clearly visible.

Most notably, in *Maxlinear/Silicon Motion* and in *Simcere Pharmaceutical/Tobishi Beijing*, SAMR stopped the clock for over six months and five months, respectively.

In *Maxlinear/Silicon Motion* the sales and purchase agreement was signed in May 2022, and the transaction was filed with SAMR in September 2022. At the beginning, the procedure developed quite normally: after six weeks, SAMR accepted the case on file and entered into phase 2 one month after case acceptance. Then, however, mid-way through phase 2 on 6 January 2023, the clock was stopped for over six months until 14 July 2023 (eight days before clearance).

In *Simcere Pharmaceutical/Tobishi Beijing*, after filing in June/July 2023, the procedure was suspended half-way through phase 3 on 25 April 2023 and resumed on 21 September 2023, one day before clearance.

In *Broadcom/VMWare*, the clock was stopped for around two months, again around half-way into phase 3, and resumed four days before clearance.

In *Korean Air/Asiana*, deducting from the timelines in the public decision, the stop-the-clock freeze lasted around two months. Assuming the freeze was ordered only after the amended AML came into effect, it is likely that it occurred in phase 3 (in the second re-filing, making it effectively phase 9) of the procedure.

As key learnings from these recent cases, *Broadcom/VMWare* apart, the procedure was always suspended mid-way through phase 3 of the procedure and resumed just a handful of days before clearance. (The reason the clock was stopped earlier in *Broadcom/VMWare*, in phase 2, may be due to the fact that it already took SAMR more than seven months to accept the case on file in the first place.) In all four cases, there were no further explanations in SAMR's public decisions about the reason for stopping the clock and about the length it took to resume the procedure.

Below-thresholds investigations

Another major change brought about by the AML amendment was that SAMR now has the legal basis – legal in a formal sense – to investigate transactions below the filing thresholds. At least in part, the addition of this new provision to the AML responds to the perceived need to be able to investigate "killer acquisitions." Although an AML implementing regulation contained essentially the same provision even before the AML amendment, SAMR and its predecessor had never used it, at least to adopt a formal and public decision on its basis.

Now, on 22 September 2023, SAMR seemed to have adopted its first public decision in a below-thresholds investigation case. On that day, SAMR cleared the acquisition by Simcere Pharmaceutical ("**Simcere**") of Tobishi Beijing ("**Tobishi**") subject to conditions.

The SAMR decision states that the filing thresholds were not met but that Simcere "voluntarily" filed the transaction. There were no further explanations on this point in the decision, so it is unclear why SAMR did not launch a below-the-thresholds investigation but Simcere voluntarily filed.

In any event, on its face, the *Simcere Pharmaceutical/Tobishi Beijing* transaction looks very much like a scenario where SAMR "calls in" a transaction below the thresholds.

In short, although the case had its own very special features (in particular, Simcere had already been fined for abuse of dominance in violation of the AML in 2021), the *Simcere Pharmaceutical/Tobishi* decision may give a glimpse of how SAMR's below-thresholds investigation under the amended AML could look like. On the substance, the SAMR decision would confirm the assumption that the life sciences industry is a key enforcement area for SAMR's below-threshold investigations. Procedurally, a key takeaway may be that the below-the-thresholds procedure can take quite long. In this transaction, close to 15 months passed from Simcere's filing until SAMR clearance. What lasted long were, first, the close to five months for the initial dialogue (from filing to case acceptance) and, second, the close to five months in phase 3 during which the clock was stopped.

Stability of supply as new theory of harm?

Turning to the substance of merger control, there was no significant change brought about by the AML amendment in 2022.

However, in the *Maxlinear/Silicon Motion* case, SAMR put forward a new theory of harm which had not been present (at least in the published decisions) in past cases.

That case concerned a transaction between a US buyer (Maxlinear), designing telecommunications system-on-a-chips, and a Taiwanese target (Silicon Motion), active in the design of main controllers for NAND flash memory and solid state disks. SAMR's decision did not identify any horizontal, vertical or conglomerate relationship between the buyer's and the target's products. Instead, it focused the analysis exclusively on the target's NAND flash memory controller chips. SAMR noted that the target had a market share above 50% and customers relied heavily on its products.

Against this background, SAMR stressed that Silicon Motion's Chinese customers expressed "concern that the transaction would likely affect the stability of product supply." It concluded that "if a problem arises in the supply of Silicon Motion's products, not only would other competitors have difficulties in satisfying the demand by downstream customers in the short run, but [this] would bring about increases in the price of the relevant products in the Chinese market and harm competition in the relevant market."

While the SAMR decision was refreshingly open about the real concern of the Chinese market players and by extension SAMR, it did not expressly lay out the last step in the reasoning: the transaction would put the ownership of the NAND flash memory controller chips into the hands of a US corporation, which could presumably make it more likely to become subject to US export control rules. If so, their supply to Chinese customers may be curtailed, hence the stability-of-supply concerns.

As we can see, the *Maxlinear/Silicon Motion* decision raises interesting new questions. On its face, the reasoning can be followed: a supply stop would affect competition downstream, putting Chinese solid-state disk makers at a disadvantage. In contrast, it would be less clear whether the concern is merger-specific, as the application of US export control rules does not depend on where the company is headquartered but about how much and how important technology is developed in the United States. Hence, the change of ownership resulting from the transaction alone does not affect the applicability of US export control rules. More fundamentally, the key question is whether the concern is a proper theory of harm under antitrust rules.

"Killer acquisition" theory of harm

The second novel theory of harm appeared in the *Simcere Pharmaceutical/Tobishi Beijing* case: the "killer acquisition" theory of harm. Like it or not, different from the stability-of-supply theory, this theory of harm is in line with recent international antitrust developments.

The facts were as follows. Simcere is a producer of an active pharmaceutical ingredient ("**API**") to produce batroxobin, a drug mainly aimed at treating sudden hearing loss. Simcere had secured an arrangement for exclusive supply of batroxobin API in China from a foreign company. Downstream, in the batroxobin injections market, Tobishi was the only manufacturer and supplier in China. However, Simcere was developing its own drug and, according to the SAMR decision,

was relatively close to market entry.

In its conditional clearance decision, SAMR identified both horizontal and vertical competition concerns. The vertical concern was quite straightforward: post-transaction, Simcere would have a 100% market share both upstream in the API market and downstream in the injections market, giving it the ability and incentive to engage in input foreclosure to exclude competition downstream.

The more interesting part was the analysis at the horizontal level. Here, SAMR found that Simcere was the only company engaging in R&D to develop batroxobin injections in competition with Tobishi. It held that the transaction directly removes a potential competitor and thereby consolidates the downstream dominance. To alleviate the concern, SAMR imposed the divestiture of Simcere's batroxobin injections business as a remedy.

In other words, SAMR's reasoning is a classic "killer acquisition" theory of harm, as it expressed concern that Simcere would discontinue its own R&D program and stop bringing to the market a competing batroxobin injection product. The only peculiarity of the *Simcere Pharmaceutical/Tobishi Beijing* case was that the concern was "killing" the buyer's own business, not the target's.

Again, it is not surprising that SAMR used the "killer acquisition" theory of harm for the first time in *Simcere Pharmaceutical/Tobishi Beijing*. Indeed, as in other jurisdictions, the life sciences industry is one of the sectors where this theory is expected to be used most.

Conclusions

The simple case procedure had already become a relatively quick and smooth process before the AML amendment. the developments post-amendment suggest this will continue to be the case. If SAMR's plan to further amend the simple case procedure will materialize, the procedure could potentially become even easier.

In relation to standard cases, SAMR's case practice in 2023 has shown that the main changes brought about by the AML amendment have had an important impact on how complex transactions are reviewed and approved. On the procedural side, the remedies cases in 2023 have brought some guidance on how the stop-the-clock mechanism and below-the-thresholds investigations can work in practice.

The *Maxlinear/Silicon Motion* and *Simcere Pharmaceutical/Tobishi Beijing* decisions also gave further insights into how SAMR conducts its substantive assessment in complex deals.

Finally, the SAMR remedies decisions since the AML amendment are also illustrative to show the authority's sector priorities: among six remedies decisions, two involved semiconductor deals, two (air) transport deals, one a chemicals deal, and one a pharmaceutical deal. This selection of industries is actually in line with the past practice of SAMR and the preceding merger control authority, as around 60% of remedies decisions pre-August 2022 are related to these industries.

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