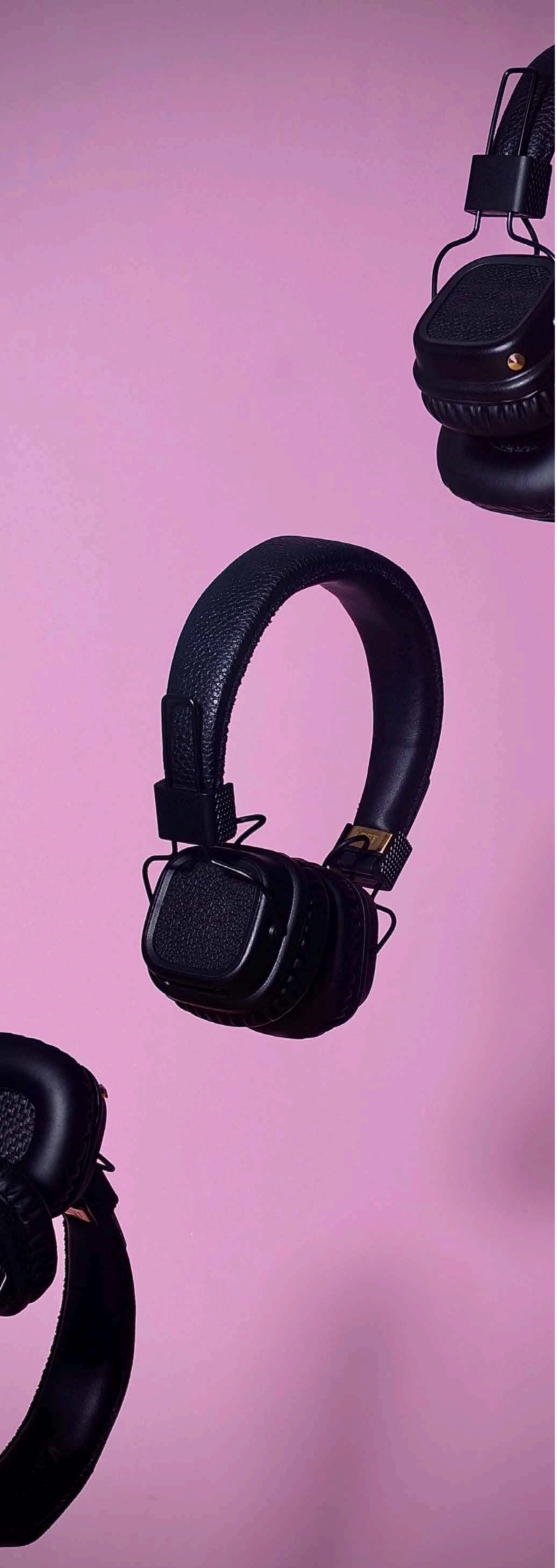

FANGDA PARTNERS
方達律師事務所

SAMR Imposes Unprecedented Conditions in a Failure to Notify Decision Involving Tencent's Acquisition of China Music Corporation

Authors:

Michael Han
Partner, Fangda Partners
michael.han@fangdalaw.com

Joshua Seet
Associate, Fangda Partners
joshua.seet@fangdalaw.com

Yu Shang
Associate, Fangda Partners
yu.shang@fangdalaw.com

On July 24, 2021, the State Administration for Market Regulation ("**SAMR**") announced a penalty on Tencent Holdings Co., Ltd. (“**Tencent**”) for its failure to notifying its acquisition of China Music Corporation ("**CMC**") in July 2016 (“**Transaction**”). The SAMR imposed a fine of RMB 500,000, and ordered Tencent to restore competition in the online music broadcasting platform market giving up exclusive music copyright licensing arrangements stopping the payment of high advances for copyright licenses, amongst others.

This case is significant because:

- It is the first time that China's anti-monopoly authority has found competition concerns in a failure to notify decision, and imposed conditions to restore competition in the market.

- The conditions imposed on Tencent are not limited to the Transaction itself, but also have a far-reaching impact on its music broadcasting platform business model market and any of its future mergers and acquisitions.

Case Overview

On July 12, 2016, Tencent (which then operated online music platform QQ Music) acquired sole control of CMC (which then operated online music platforms Kugo Music and Kuwo Music) through its acquisition of 61.64% of CMC's shares. SAMR determined that the Transaction should have been notified as the notification thresholds were crossed.

When analyzing the competitive impact of the transaction, SAMR determined that the relevant market in this case was the online music broadcasting platform market in China. Interestingly, SAMR examined various factors when determining the parties' market shares, including the number of users on each parties' music platforms, monthly usage time, sales revenues and number of songs in each parties' repertoires. It found that both parties were ranked in the top two in the relevant market in 2016, with a total market share of over 80%.

Notably, this is the first failure to notify case where SAMR concluded that the Transaction led to competition concerns in the relevant market. Amongst others, SAMR considered that the Transaction removed a major competitor from the relevant market (merger of the top two market players), and also increased barriers to entry by allowing the merged entity to lock up significant amounts of recorded music copyrights through exclusive agreement and pay high non-refundable advance fees for copyright licenses that other entrants might not be able to afford.

Penalties

Although the Anti-Monopoly Law ("**AML**") provides that the SAMR can order undertakings who implement a concentration in violation of the AML to dispose of their shares or assets and restore competition in the market, in previous failure to notify cases, such orders have never been imposed. This is the first time that the SAMR has required remedies be taken in a failure to notify case. Specifically:

1. Tencent is required to terminate the exclusive music copyright licensing.

Tencent and its affiliates have been required to take the following measures to restore competition in the market:

- terminate the exclusive music copyright licensing with upstream copyright owners within 30 days (subject to certain carve-outs);
- not to require, without justifiable reasons, an upstream copyright owner to grant Tencent conditions more favorable than those offered to other competitors;
- not to raise the costs for competitors in a disguised form through measures such as by paying high advances.

Comments:

According to the public reports of relevant media,[1] China's regulatory authorities previously paid close attention to the exclusive agreement between Tencent and upstream copyright owners. The SMAR may have used the opportunity in this decision to rectify the often-criticized practice within China of exclusive copyright for online music.

Interestingly, the SAMR did not impose a more Transaction-specific remedy such as divestments (which would have been difficult given the Transaction occurred in 2016) or behavioral commitments directly linked to conduct that formed part of the Transaction. Instead, the SAMR appears to have taken a more practical approach in formulating these set of conditions that seek to address anti-competitive practices that arose post-Transaction.

---

1. See Reuters: "Tencent Music says facing increased China scrutiny, is committed to laws", https://www.reuters.com/technology/tencent-music-posts-24-rise-quarterly-revenue-2021-05-17/, 2020.05.17.

2. Notification requirements for future M&A transactions

In relation to future M&A transactions, Tencent has been required to do the following:

Requirement	Comment
(a)If a transaction crosses the notification thresholds, it shall be notified to the SAMR in advance;	This requirement applies to all undertakings subject to the AML and are not unusual. However, in requirement (b) and (c) below, even more onerous obligations appear to have been imposed on Tencent.
(b)If a transaction does cross the notification thresholds, but may have an effect of eliminating or restricting competition, it shall be notified in advance; and	This goes beyond what is required under the AML. The SAMR might perhaps have had in mind the risk of "Killer Acquisitions", where small and medium-sized start-ups that are small enough not to meet the notification thresholds are acquired at an early stage to prevent them from becoming a potentially significant competitive force against Tencent in the future. Since the AML does not explicitly define what "may have an effect of eliminating or restricting competition", and the SAMR has the discretion in making such a finding, there could be significant uncertainty whether some cases eliminate or restrict competition, and this may lead Tencent to notify more below-the-threshold transactions to the SAMR out of prudence.
(c)If a relevant transaction does not constitute a concentration of undertakings that require notification, except for the matters concerning the protection of the rights and interests of minority shareholders as stipulated by law, Tencent shall not participate in the decision-making of the relevant entities' operations	Under this requirement, if a future Tencent transaction does not constitute a concentration of undertakings (i.e. Tencent claims that it has not acquired control over a target and the transaction therefore does not need to be notified), the rights that Tencent can obtain are only limited to the legal rights for minority shareholders. [2]This could have a significant impact on Tencent's future transactions involving minority investments e.g. in relation to the kind of governance rights over the target that it is allowed to exercise.

2. For instance, this includes the rights and interests under Company Law such as access to documents such as minutes of shareholders' meetings, resolutions of board of directors and the accounts of the company. Minority shareholders who hold more than a specified proportion of the company's shares individually or jointly may make proposals at shareholders' general meetings, request the convening of shareholders' general meetings, and veto the resolutions of amending the articles of association, increasing or reducing the registered capital, division, merger, dissolution, liquidation or change of company structure, etc.

Further Observations

1.Does this case mean that the SAMR will impose conditions other than fines on future failure to notify cases?

This case does not necessarily mean that the SAMR will impose conditions other than fines on failure to notify transactions. However, if a transaction itself triggers competition concerns, the SAMR will likely impose restrictive conditions other than fines.

2.Are exclusivity agreements no longer permitted?

The case demonstrates that the SAMR will continue to consider exclusivity agreements as an antitrust enforcement priority. However, the SAMR has also allowed carve-outs for certain exclusivity arrangements: e.g. Tencent will be allowed to enter into exclusivity agreements with independent musicians for a period of up to three years, and exclusivity for new song releases are allowed if they do not exceed 30 days. These exceptions show that the SAMR is also aware that exclusivity agreements should still be permissible in certain circumstances, and is not prohibited across the board.

Nonetheless, we expect the SAMR to continue to take a strict view towards exclusivity. Although this penalty relates to the online music broadcasting platform market, exclusivity agreements in other industries are also likely to continue to face strict anti-monopoly enforcement.

3. What is the potential impact if similar conditions are imposed on other businesses?

The conditions imposed on Tencent have far-reaching consequences on its business conduct going forward, and the same could apply to other businesses subject to similar conditions:

- **The conditions significantly impact the future business model of companies.** The requirement significantly impacts Tencent's business model by fundamentally changing Tencent's strategy when signing copyright licensing agreements with other music license owners in the future. The SAMR may impose similar restrictive conditions against exclusivity and in other areas in other failure to notify cases if the market situation calls for it, which could have a significant impact on the business model of affected companies subject to such conditions.

- **The conditions directly affect a company's future M&A transactions.** Any undertaking subject to similar requirements as Tencent in relation to the future M&A transactions may now need to:

  - Consider whether it will obtain rights other than minority shareholders' protection rights and interests stipulated by the law in transactions involving the acquisition of minority interests without control, given the prohibition on acquiring anything other than minority protection rights; and

  - For transactions that constitute a concentration of undertakings but do not meet the notification threshold, analyze whether the transaction can eliminate or restrict competition and then judge whether it needs to be notified in advance.

4. What is the maximum fine that can be imposed for a failure to notify?

The AML currently caps failure to notify fines at RMB 500,000. While Tencent was fined RMB500,000 in this case, the AML is currently being revised and the amendments are expected to be adopted within this year. Under these amendments, the penalties for a failure to notify has been proposed to be increased to a maximum of less than 10% of the undertaking's turnover in the previous year. After these amendments, the final amount could be substantial, especially if the undertaking's turnovers are significant.

Beijing

27/F, North Tower
Beijing Kerry Centre
1 Guanghua Road
Chaoyang District
Beijing 100020, China

Tel: +86 10 5769 5600
Fax:+86 10 5769 5788

Guangzhou

17/F, International Finance Place, 8 Huaxia Road,
Zhujiang New Town
Guangzhou 510623, China

Tel: +86 20 3225 3888
Fax:+86 20 3225 3899

Hong Kong

26/F, One Exchange Square
8 Connaught Place, Central
Hong Kong

Tel: +852 3976 8888
Fax:+852 2110 4285

Shanghai

24/F, HKRI Centre Two,
HKRI Taikoo Hui
288 Shi Men Yi Road
Shanghai 200041, China

Tel: +86 21 2208 1166
Fax:+86 21 5298 5599

Shenzhen

17/F, Tower One, Kerry Plaza
1 Zhong Xin Si Road
Futian District
Shenzhen 518048, China

Tel: +86 755 8159 3999
Fax:+86 755 8159 3900