

MOFCOM Cracking Down on Failures to Notify Qualifying Mergers, Acquisitions and Joint Ventures

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China's Anti-Monopoly Law requires businesses to notify transactions to the Ministry of Commerce (MOFCOM) for merger control review, so long as the parties meet certain revenue thresholds¹ and the transaction involves a change of control or the establishment of a joint venture.²

Despite these requirements, many businesses — both Chinese and multinational — try to avoid such a filing. Multinational companies may fear the potential length and complications that can arise during MOFCOM review, while some Chinese companies may have the (outdated and unsupported) perception that Chinese businesses need not be as rigorous as multinationals in observing the filing requirements.

MOFCOM has been working hard to change these perceptions and has made clear that qualifying transactions must be notified or the offending businesses will face fines or worse.

First, in December 2014, MOFCOM for the first time made public a decision to penalize a purchasing company for failing to notify an acquisition.³ Strikingly, the transaction in question involved the acquisition by a state-owned enterprise (SOE) (Tsinghua Unigroup) of a target company in an area of acknowledged key importance for China's national economic and industrial development — namely, the semiconductor industry. While the fine itself was not substantial (CN¥300,000, or approximately US\$47,500), the publicized decision sent a message that MOFCOM would make no exceptions for failures to notify qualifying transactions — not for SOEs (let alone other Chinese companies), nor even for increasing Chinese ownership in important industrial sectors.

More recently, on September 29, 2015, MOFCOM published four additional decisions penalizing companies for failing to notify qualifying transactions. Two of the decisions involved the failure to notify establishment of a joint venture between a multinational and its Chinese partner. The other two decisions involved multistep acquisitions and levied penalties for premature or partial implementation of an acquisition prior to MOFCOM's approval of the transaction as a whole. The four decisions are part of a larger campaign by MOFCOM, which has indicated that it has opened more than 50 such investigations (the large majority of which the ministry is handling privately), of which 20 or so remain ongoing.

Failure to Notify Joint Ventures

The two joint venture cases involved (i) the establishment of a joint venture by Microsoft with BesTV New Media, and (ii) the establishment of a joint venture by Bombardier Transportation Sweden and CSR Nanjing Puzhen. The Anti-Monopoly Law requires a far broader range of joint ventures to be notified than similar laws in other jurisdictions. For example, the statute requires notification even for joint ventures that only service their respective parents and have no outward, customer-facing functions or true independent economic existence — such joint ventures would not be caught by merger control rules in many jurisdictions, including the European Union.

¹ A filing will be required where (i) at least two parties to the transaction each have individual sales to Chinese customers exceeding CN¥400 million (approximately US\$63 million); and (ii) the combined turnover of all parties exceeds CN¥10 billion on a worldwide basis (approximately US\$1.6 billion) and/or exceeds CN¥2 billion in China (approximately US\$310 million).

² See Anti-Monopoly Law Art. 20, 21.

³ Prior to December 2014, MOFCOM had ordinarily resolved perceived failures to file privately, through bilateral discussions with the parties (which could include fines and requirements to draft and submit notifications and proceed with the required review).

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As a result of the breadth of the joint venture filing requirement, parties must be particularly vigilant in ascertaining whether a joint venture requires a filing to MOFCOM, even when the transaction may be exempted from filing requirements in the United States, European Union or other jurisdictions. This inconsistency can occasionally lead to failures to notify.

Notably, MOFCOM's investigation into the *Microsoft/BesTV* transaction appears to have been triggered by a third-party complaint, while in *Bombardier/CSR Nanjing Puzhen*, the parties discovered their failure on their own and voluntarily notified the transaction to MOFCOM. Indeed, third-party complaints are fast becoming a favorite enforcement tool for MOFCOM (and a tactical tool of Chinese rivals). Multinationals doing business in China must be on guard that publicly announced transactions may receive heightened scrutiny from their competitors, customers and suppliers in China, with a perceived failure to file providing additional leverage for such rivals attempting to extract commercial concessions or simply impede or delay a transaction.

In both joint venture decisions, MOFCOM acknowledged with appreciation that the parties rectified their failures by preparing and submitting supplemental notifications to MOFCOM and proactively cooperating during the investigation. Bombardier and CSR Nanjing Puzhen were each fined CN¥150,000 (approximately US\$23,500), while Microsoft and BesTV were each fined CN¥200,000 (approximately US\$31,500). The reduced fine for Bombardier and CSR Nanjing Puzhen likely resulted from their voluntary notification and active cooperation.

Failure to Notify Multi-Step Acquisitions

The two other decisions involved multistep acquisitions: (i) the acquisition of Shenzhen CHINO-E Communication Co., Ltd. by Fujian Electronics & Information (Group) Co., Ltd.; and (ii) the acquisition of Suzhou Erye Pharmaceutical Co Ltd by Shanghai Fosun Pharmaceutical (Group) Co., Ltd.

In these cases, each penalized acquisition involved an initial minority share acquisition forming part of a larger overall trans-

action (with the larger transactions in fact being duly notified to MOFCOM). In *Shanghai Fosun/Suzhou Erye*, Shanghai Fosun planned to acquire a 65 percent stake in the target by purchasing 35 percent of the shares itself and then purchasing 30 percent through an overseas subsidiary. Shanghai Fosun notified MOFCOM regarding its overall intention to acquire the controlling 65 percent stake but had completed the 35 percent share transfer prior to MOFCOM's approval. MOFCOM considered this to constitute an improper implementation and fined Shanghai Fosun CN¥200,000 (approximately US\$31,500).

In *Fujian Electronics/Shenzhen CHINO-E*, Fujian Electronics signed an agreement to acquire 35 percent of Shenzhen CHINO-E without notifying MOFCOM. Two weeks later, a Fujian Electronics subsidiary entered into an agreement to purchase 100 percent of Shenzhen CHINO-E's shares, duly notifying MOFCOM. MOFCOM fined Fujian Electronics CN¥150,000 (approximately USD 23,500) for this implementation.

These two cases suggest that MOFCOM will interpret its worldwide bar on closing and implementation strictly,⁴ such that no subsidiary part of an overall change of control transaction should be implemented prior to approval. Even where the parties intend subsequently to notify the entire transaction, the parties should still carefully assess gun-jumping risks in each part of the transaction and make sure that no initial steps could run afoul of MOFCOM's bar on closing.

Conclusion

Both Chinese companies and multinationals must diligently ascertain whether their transactions are subject to a filing requirement in China. This is particularly important for joint ventures and multistep transactions, which can present unique complications in China not present in other jurisdictions.

⁴ Anti-Monopoly Law Art. 21 directs that parties meeting the transaction thresholds "shall not implement" their transaction absent MOFCOM approval.

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