

China's MOFCOM Announces First-Ever Gun-Jumping Penalty in a Transaction Not Involving a Chinese Company

MOFCOM continues efforts to increase enforcement of its merger notification requirements, despite very limited penalty options.

On January 4, 2016, China's Ministry of Commerce (MOFCOM) announced that it had fined Japanese optics company Canon Inc. (Canon) CNY300,000 (approximately US\$43,000) for not obtaining antitrust approval from MOFCOM prior to implementing the first step of its two-step acquisition of Toshiba Medical Systems Corporation (Toshiba Medical). Both companies are Japan-headquartered, making this the first publicly-announced MOFCOM "gun-jumping" penalty for a transaction not involving a China-headquartered entity.

Background of Canon's Acquisition

Canon's March 2016 acquisition agreement provided for a two-step transaction that would result in Canon owning 100% of the shares of Toshiba Medical. Prior to the transaction, three types of Toshiba Medical equity rights would be created: 20 Class A voting shares, one Class B non-voting share, and 100 warrants convertible into common voting shares. Also, three individuals would form a special purpose vehicle (SPV) for the transaction. Following these initial preparatory actions, there would be two transaction steps:

First, immediately upon signing the transaction agreements, the SPV would acquire the Class A voting shares, and Canon would acquire the Class B non-voting share and the 100 warrants. At the same time, Canon would transfer the full purchase price to the seller. This preliminary first step would allow Canon to immediately transfer the purchase price to the seller without waiting for antitrust approvals because Canon would not obtain voting rights that might confer control over Toshiba Medical. Instead, the SPV would obtain the voting rights.

Second, after Canon submitted antitrust notifications in China and elsewhere, and received the associated approvals, it would exercise the warrants it acquired in the first step and receive Toshiba Medical common voting shares for a payment of ¥100. In addition, the Toshiba Medical Class A and Class B shares would be bought back from Canon and the SPV, and canceled.

The Gun-Jumping Investigations

Based on a whistleblower report, MOFCOM launched a gun-jumping investigation in October 2016. Thereafter, and before Canon implemented the second step of the transaction, Canon submitted a merger notification to MOFCOM.

MOFCOM's investigation followed a similar investigation of the transaction in Japan by the Japan Fair Trade Commission (JFTC) that concluded in June 2016. The JFTC approved the transaction, but issued a warning that it viewed the two-step approach as "likely to lead to activity that could violate" Japan's merger control law. The authority did not find a violation of Japan's merger control law, nor did it assess any fines or other penalties.

On January 4, 2017, MOFCOM announced that it had decided that the two-step approach violated China's Antimonopoly Law (AML). MOFCOM found that the two steps were closely related and indispensable components of a single transaction. Therefore, it concluded that Canon should have notified both steps prior to implementation of the first step, but that Canon had deliberately delayed the notification. MOFCOM imposed a fine of CNY300,000 (approximately US\$43,000), which is less than the maximum fine of CNY500,000 (approximately US\$72,000). MOFCOM also noted that it had not found competition issues with the transaction and approved it under the AML.

On January 5, 2017, a Canon spokesman told industry press that Canon is considering filing a complaint against the Chinese government regarding the fine. The AML contains two avenues for appeal of a fine — an application for administrative reconsideration by MOFCOM, and an administrative lawsuit against MOFCOM in a Beijing intermediate court. A typical approach would be an application for administrative reconsideration followed by a lawsuit against MOFCOM if the reconsideration does not overturn the initial decision.

Practical Implications for Transaction Structuring and Global Merger Control

MOFCOM claimed that the fact that the two-step approach was intended to allow swift payment of the purchase price to the seller shows that the parties were aware of antitrust approval obligations but deliberately delayed the notification. The decision unfortunately does not provide guidance as to why MOFCOM viewed the actions that were part of the first step of the transaction as implementation of a notifiable transaction rather than preparations for the later transfer of voting shares to Canon. The outcome does not rule out that MOFCOM might find other related multi-step transaction structures compliant with the AML.

Parties contemplating a transaction structure designed to allow immediate implementation of key transaction steps should carefully analyze the likely response by antitrust regulators in China and elsewhere. In some cases, parties may consider previewing the plan with MOFCOM and other antitrust authorities prior to implementation, particularly where there are pro-competitive business reasons why immediate execution of funds transfers or other actions are critical.

As a practical matter, MOFCOM's available penalties for gun-jumping are relatively limited. The maximum penalty for a failure to obtain pre-approval under the AML currently is CNY500,000 (approximately US\$72,000). MOFCOM acted to enhance the impact of its gun-jumping decisions in 2014 by initiating a public announcement procedure that is similar to the approach used in the US and elsewhere. Since that time, MOFCOM has announced nine gun-jumping decisions. The new publicity has increased the potential reputational impact of gun-jumping decisions both with respect to the public and Chinese government entities, but it is unclear what true deterrent effect it has had.

MOFCOM's actions with respect to Canon do confirm that it remains focused on identifying transactions that parties failed to file and imposing public fines. Moreover, it will not limit its focus to transactions involving Chinese companies. The timing of notifications to antitrust authorities in multiple-step transactions must be carefully evaluated by experienced global merger control counsel.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Jason D. Cruise

jason.cruise@lw.com
+1.202.637.1033
Washington, D.C.

Abbott (Tad) B. Lipsky, Jr.

tad.lipsky@lw.com
+1.202.637.2283
Washington, D.C.

Catherine E. Palmer

catherine.palmer@lw.com
+852.2912.2626
Hong Kong

Hui Xu

hui.xu@lw.com
+86.21.6101.6006
Shanghai

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