# China cracks down on failure to file reportable M&A deals

Over the past year and a half, the review procedure before China's merger control authority – the Ministry of Commerce ("**MOFCOM**") – has become more streamlined, and faster, in many instances. Since the introduction of the "simple case" review system in February 2014, many transactions that do not raise major issues have benefited from less far-reaching document production obligations, and have been cleared in a considerably shorter period of time compared to the situation before. Following a very recent internal reshuffle at MOFCOM's Anti-Monopoly Bureau, the number of case teams and handlers working on a transaction has decreased, which may lead to further efficiencies and faster approvals.

Largely in parallel to this process, another development in Chinese merger control has occurred: MOFCOM is increasingly focusing on transactions which were not reported despite meeting the filing criteria. This focus became apparent last year when MOFCOM announced it would make public all "failure to file" decisions, sanctioning companies for breaching the Anti-Monopoly Law ("**AML**"), from May 2014 onwards.

The first failure to file decision was published in December last year (see here). That case concerned the acquisition by Tsinghua Unigroup of 100% of shares in RDA Microelectronics. Just before the National Day vacation started in 2015, MOFCOM made public four additional decisions which deal with transactions of different complexities.

**The new decisions and their impact**

On 29 September 2015, in what could be interpreted as a "desk cleaning effort" before the holidays, MOFCOM posted on its website four decisions sanctioning companies for failing to file reportable transactions. The decisions send the signal that MOFCOM is ready to tackle failures to comply with the merger filing obligation – and does not shy away from taking on powerful companies. Three of the companies fined were Chinese state-owned enterprises, and another one was Microsoft.

The September 2015 decisions are interesting, as they go beyond the case of a 100% acquisition. First, two of the decisions challenged the unreported establishment of joint ventures (*BesTV New Media/Microsoft* with 51/49%, and *CSR Puzhen/Bombardier Transportation* with 50/50%). Second, in the *Fujian Electronics and Information Group/Chino-E Communications* case, the acquirer had parceled the acquisition of the target's shares into two tranches – the acquisition of 35% shares by the parent company, followed by the acquisition of the entirety of shares by a subsidiary – with separate sales and purchase agreements (signed within the course of about two weeks). The acquirer notified the 100% acquisition to MOFCOM under the AML. However, the authority found that the first tranche already constituted an acquisition of a "controlling right" – one of the filing criteria – and was therefore a reportable transaction.

In the fourth transaction – Fosun Pharmaceutical Development's acquisition of 65% shares in Suzhou Erye Pharmaceuticals – the situation was similar, though not identical. Rather than slicing the transaction into two tranches, the acquirer bought two sets of stakes (35% and 30% shares, respectively) from two different affiliates within the target group, and transferred the 35% stake during the course of its pre-notification talks with MOFCOM. The authority's ruling in this case could be interpreted as China's first "gun jumping" decision.

The gist of these decisions seems to be that attempts to (re-)structure a transaction to avoid a MOFCOM filing, for full or part of the transaction, may prove difficult. At the same time, in the current normative efforts to amend its

2009 Notification Measures, MOFCOM's draft proposal suggests that initial share purchases – which on their own do not lead to the acquisition of a "controlling right" – in a multi-step transaction would not trigger filing obligations.

Additional, though indirect, guidance on "gun jumping" was contained in the joint venture cases. In particular, the joint venture agreement between CSR Puzhen and Bombardier Transportation was signed on 3 November 2014 and, following the parent companies' capital contributions, the joint venture company obtained the business license on 11 November. On 29 December 2014, the parent companies self-reported to MOFCOM. This short period of time shows, clearly, that MOFCOM believes the "gun jumping" prohibition kicks in where a joint venture is set up even before it has become fully operational. The MOFCOM decisions in both the *BesTV New Media/Microsoft and CSR Puzhen/Bombardier Transportation* cases note that "the joint venture company was already established, but the two parties had not notified to [MOFCOM] before implementing."

Beyond the failure to file issues raised in the four decisions, the decisions have implications for the concept of a "controlling right," one of the filing criteria. While the decisions do not contain any specific guidance on why MOFCOM concluded that the acquisition of a 35% stake gives rise to a "controlling right" in the particular circumstances of the cases, they show that in the regulator's view minority shareholdings can – at least under certain circumstances – be interpreted as conferring "controlling rights." This implication is interesting, especially in the context of MOFCOM's continuing normative efforts: the proposed amendments to the 2009 Notification Measures may provide further guidance on what a "controlling right" means in terms of veto rights, possibly bringing China in line with European Union competition law.

**The sanctions**

Two of the decisions carried a fine of RMB 150,000 (around USD 24,000) each, while the other two totaled RMB 200,000 in fines (around USD 32,000) per decision. The level of the fines may not be considered high by the standards of some observers, and clearly fall below the cap set out in the AML (*i.e.*, RMB 500,000). Past statements by MOFCOM officials indicate that they do not view the fines to be a major deterrent against failure to file conduct, and it is possible that there will be pressure to amend the cap as the revision of the AML has been put on the legislative agenda.

Yet MOFCOM has other deterrence mechanisms in its tool box. The most powerful, of course, is that the authority could order the unwinding of a transaction, though the general understanding is that it would do so only if the transaction at issue brought about significant anti-competitive effects. In the four September 2015 decisions, MOFCOM examined the substance of the transactions but found no anti-competitive effects to exist.

The other main deterrence mechanism was used in these cases – the publication of the decision finding a violation of the law, which can lead to negative reputational consequences for companies.

**Takeaways**

With the four decisions, MOFCOM signals its increased appetite for bringing failure to file cases. With the streamlined procedure for "simple cases," the regulator may be following a sort of "carrot and stick" approach: easier if companies do file, but tougher when they do not.