

CPI's Asia Column Presents:

“Gun Jumping” under the AML Merger Control Rules

- Analysis of the two-stage transactions of Canon takeover Toshiba Medical Systems

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January 2017



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On January 4th, 2017, MOFCOM released its Decision of Administrative Penalty ([2016] No.965) in which it concluded that Canon's failure to notify MOFCOM of the concentration before the first stage of the transaction (the acquisition of all the shares of Toshiba Medical System) constituted a violation of the AML. As stated in MOFCOM's decision, the transaction consists of two stages, and Canon didn't notify MOFCOM until the first stage of the transaction had been completed. MOFCOM found that Cannon is liable for its non-notification relating to its purchase of all shares of Toshiba Medical Systems and fined Canon CNY 300,000.

Since this is the first time MOFCOM concluded that the completion of the first stage of a transaction, even the control of the target company has not been transferred, is in violation of the AML, there is no doubt this case will have important guiding significance for all the undertakings facing similar situations.

1. What is "gun jumping" under the AML Merger Control Rules?

Gun-jumping, means the acquisition of control of the target company before the approval of the anti-monopoly enforcement agencies (for example, MOFCOM), including using all kinds of methods to influence the act or the operation of the target company.

Usually, the way to determine whether an undertaking has conducted "gun-jumping" is to see whether the undertaking has taken control of another. For example, in the acquisition of 50% shares of Jilin Sichang Pharmaceutical Co., Ltd by Dade Holdings Ltd. ("Dade"), the transaction was divided into two stages, and Dade only got 19% shares of Sichang through the first stage. The control of Sichang wasn't transferred till the completion of the second stage through which Dade got another 31% shares of Sichang. In the Administrative Penalty Decision, MOFCOM concluded the parties involved in the transaction had violated the AML when Dade got more than 50% shares of Sichang, but didn't clarify whether the completion of the first stage by obtained 19% share is in violation of the AML.

Now, *Canon/Toshiba Medical System* has sent the clear message that undertakings might need to notify MOFCOM even the control of the target company hasn't been transferred through the first stage of the transaction. The *Canon/Toshiba Medical System* decision could be considered as a precedent of MOFCOM in dealing with the similar situation.

2. The standards of "gun-jumping" set in *Canon/Toshiba Medical System*

MOFCOM has established a standard of the determination of "gun-jumping" in *Canon/Toshiba Medical System*:

- (1) Even the transaction consists of many stages, all stages can be treated as one concentration of undertakings;
- (2) The transaction is a concentration of undertakings and meets the threshold of notification;
- (3) The first stage of the transaction has been completed (no matter whether of the target company has been transferred).

When the foregoing requirements are fulfilled, MOFCOM will very likely conclude "gun-jumping" has been committed, and a fine from MOFCOM is expected.

2.1 Whether the two stages in *Canon/Toshiba Medical System* are independent transactions?

The key to determine whether “gun-jumping” has been committed is to determine whether the two stages can be regarded as independent transactions. If the answer is yes, since the control of the target company hasn’t been transferred in the first stage, and Cannon has notified MOFCOM before the second stage, the conclusion is no “gun-jumping” has been committed.

As stated in the decision of MOFCOM, the transaction consists of two stages: the preparation stage, the first stage and the second stage:

The preparation stage: (1) Launching a SPV MS Holding owned by three natural persons; (2) Dividing all the shares issued by Toshiba into three categories: 20 class-A shares (shares with voting rights); 1 class-B share (shares without voting rights); 100 stock options.

The first stage (finished before the notification): (1) SPV signed agreement with Toshiba to buy 20 class-A shares; (2) Canon signed agreement with Toshiba to buy 1 class-B share and 100 stock options.

The second stage: (1) According to the agreement between Canon and Toshiba, Canon will exercise the 100 stock options and convert the options into common stock with voting rights; (2) Toshiba will repurchase all class-A and class-B shares and write them off.

MOFCOM holds the view that though the transaction consists of two stages, but the two stages are closely related, the two stages are all necessary parts of the transaction, the completion of the first stage constitutes violation of Article 20 of the AML.

Based on the decision made by MOFCOM, we understand that the uncertainty of the approval of the anti-monopoly enforcement agencies (including MOFCOM) isn’t sufficient to prove the independence of the two stages, though the approval has been set as the precondition of the second stage.

Generally speaking, if a transaction consists of many stages, the undertakings should consider carefully whether to notify MOFCOM before the first stage even in most occasions the control of the target company won’t be transferred after the first stage. In the case the undertakings believe the stages are all separate transactions, a consultation with its anti-monopoly lawyer about the legitimacy of the transactions is advised, otherwise, there might be risks of committing “gun-jumping”.

2.2 Conduct of Gun-jumping

Gun-jumping determined in *Canon/Toshiba Medical System* is the completion of the first stage, which means the shares transferred, and the payments completed.

Except for conduct in *Canon/Toshiba Medical System*, whether there exists other forms of “gun-jumping” is still not clear unless more “gun-jumping” cases are released by MOFCOM. As we understand, “gun-jumping” is always hard to be detected and could have different forms, so it should be determined on a case-by-case basis.

2.3 The control of the target company hasn’t been transferred can’t be a defense

We have noticed that at the point the first stage of the transaction was completed, what Canon has gotten are simply 1 class-B share and 100 stock options. The transaction was designed

so elaborately to evade taking control of the target company through the first stage, so as to evade the obligation to notify the anti-monopoly enforcement agencies of the concentration. However, in *Canon/Toshiba Medical System*, MOFCOM didn't find the lack of the control of the target company by Canon a valid defense.

Thus, after *Canon/Toshiba Medical System*, if a transaction consists of many stages and the undertakings are dubious about whether or not to notify MFOCOM of the transaction, more factors should be considered, including: whether the control of the target company has been transferred, the date the agreement signed, the time between adjacent stages, trade terms, irreversible transaction arrangements, etc.

3. Conclusion

It has been 5 years after the promulgation of the *Interim Measures for Investigation and Handling of Concentrations between Undertakings Not Notified in Accordance with the Law*. MOFCOM has dealt with many cases in which the undertakings failed to fulfill their obligations to notify, and the number of such cases is growing vigorously. *Canon/Toshiba Medical System* is a breakthrough for MOFCOM on basis of its practices. There is no doubt this case will have a profound impact on the future M&A and notification of concentration process.