

CPI's Asia Column Presents:

Merger control filing issues regarding transactions involving multi-steps arrangement

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As one of the most common types of transactions, transactions involving multi-steps arrangement have been widely adopted in M&A deals. According to the Anti-Monopoly Law of China (“AML”), transactions that constitute concentration and fulfill the thresholds for filing merger control are required to notify to the MOFCOM before the concentration is implemented. However, several recent transactions⁴ involving multi-steps arrangement such as Meinian Onehealth/Ciming Checkup have been challenged by the Ministry of Commerce (“MOFCOM”) and corresponding filing parties were penalized for failing to file merger control according to AML (“gun-jumping”), and these cases shall ring the bell for parties of similar arrangement to consider more carefully about these following questions: whether the transaction involves one concentration, thereby one merger filing is required, or involves several concentration, thereby several merger filing is required? what is the appropriate time to file merger control to the MOFCOM? In this article, we would like to present and analyze recent typical transactions involving multi-steps arrangement that were penalized by the MOFCOM for gun-jumping, discuss about relevant regulations in EU competition law and law enforcement practice, and share our opinions on merger control filing issues regarding this type of transactions.

I. An analysis of MOFCOM’s core concerns regarding multi-steps transactions from recent typical cases

1. Meinian Onehealth/Ciming Checkup case⁵

On May 11, 2017, the MOFCOM published its penalty decision against Meinian Onehealth regarding its gun-jumping behavior. This is the most recent transaction involving multi-steps arrangement that was challenged by the MOFCOM. In this case, there are several steps as well as parties involved, the case derived from a competitor’s real-name report, relatively complicated, and is worthy of analysis and discussion. According to the penalty decision, the background of the transaction was:

In the concentration agreement, relevant parties agreed upon that Meinian Onehealth’s acquisition of Ciming Checkup 100% stock would comprise two steps, they stipulated the details of the first step 27.78% stock transfer (①), while made an advance arrangement for the rest 72.22% stock.

After the 27.78% stock transfer completed, the transfer of 72.22% stock was carried out in three steps:

- ◆ Affiliated party Tianyi Ziguan acquired 68.40% stock of Ciming Checkup (②)
- ◆ Affiliated party Weitu Investment acquired Ciming Checkup’s 36.11% stock from Tianyi Ziguan (③)

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⁴ In 2017 until this article is published, the MOFCOM has published penalty decisions for relevant filing parties of 9 transactions, demonstrating a further enhanced law enforcement.

⁵ See MOFCOM’s decision for Meinian Onehealth at <http://fdj.mofcom.gov.cn/article/ztxx/201705/20170502573416.shtml>

◆ Affiliated party Meinian listing company proposed to acquire 72.22% stock of Ciming Checkup from Ciming Checkup's all shareholders except Meinian Onehealth (④)

Before implementing step ④, Meinian listing company filed merger control to the MOFCOM. The competitor reported to the MOFCOM regarding Tianyi Ziguan's acquisition of 27.78% stock for implementing step ② without filing merger control.

The MOFCOM believed that, step ①, ②, ③, ④ is a "one package deal" that was conducted by several relevant parties and through several steps, these steps were implemented and carried out one by one, with strong interdependence between each other and same ultimate purpose; moreover, the power of control over the target undertaking Ciming Checkup was finally obtained by the same undertaking as well as its affiliates, therefore, these steps constitute one concentration. Given that step ①, ② and ③ have been implemented without filing concentration in advance, the MOFCOM found that Meinian Onehealth jumped the gun.

Although the MOFCOM believed the Meinian Onehealth/Ciming Checkup deal constituted one concentration, according to public information⁶, it appears that except step ①, there are also some noticeable features in many aspects showed in the acquisition of 72.22% stocks of Ciming Checkup:

➤ **Substantive provisions of the deal required separate negotiation:** for the acquisition of the rest 72.22% stocks of Ciming Checkup, relevant shareholders of Ciming Checkup and Meinian Onehealth would negotiate about the specific percentage of shares, consideration and payment methods, payment schedule, and other substantive provisions of the deal after completion of 27.78% stocks transfer;

➤ **Shareholders of Ciming Checkup may refuse to transfer the rest 72.22% stocks and bear no responsibility:** the shareholders of Ciming Checkup may negotiate with Meinian Onehealth regarding the 72.22% stocks transfer according to their free will, as there is no penalty clause for shareholders of Ciming Checkup if they refuse to transfer relevant stocks, it is highly possible that the shareholders of Ciming Checkup would refuse to transfer shares to Meinian Onehealth if no consensus is reached;

➤ **Under certain conditions, shareholders of Ciming Checkup would have the right to repurchase the stocks that have been transferred:** although Meinian Onehealth planned to purchase the rest of stocks of Ciming Checkup, if relevant parts of the rest 72.22% stocks cannot be transferred in cash before December 19, 2015, shareholders of Ciming Checkup would be entitled to repurchase the 27.78% stocks.

Therefore, from the provisions of the concentration agreement, there are some uncertainties during the execution of 72.22% stocks transfer.

In fact, there were some variable matters during the actual execution of the 72.22% stocks transfer: after step ① was completed, relevant parties signed revised agreement and then supplementary agreement regarding the specific arrangement of the 72.22% stocks transfer, transfer of 72.22% stocks were actually carried out in three steps, and affiliates of Meinian Onehealth (namely Tianyi Ziguan, Weitu Investment, Meinian Listing company) also participated in different steps of the transaction. **Therefore, the above uncertainties did affect the execution of concentration**

⁶ See Meinian Onehealth Industrial holding Co.'s announcement regarding the responses to inquires by Shenzhen Stock Exchange at <http://finance.sina.com.cn/roll/2016-08-02/doc-ifxunuyk4329242.shtml>

agreement to some extent.

Even so, considering that: (1) the leading role of Meinian Onehealth and its actual controller, (2) Meinian Onehealth was one of the parties to the concentration agreement so as to purchase Ciming Checkup 100% stocks, and then was the signing party, beneficiary, acquirer of the control power of Ciming Checkup, Meinian Onehealth was the informed party while its affiliate Tianyi Ziguan and Weitu Investment were appointed to temporarily and transitionally purchase Ciming Checkup's stocks, and (3) Meinian Listing company did not exist at the time of reaching the concentration agreement, the MOFCOM still found Meinian Onehealth RMB 300,000 for gun-jumping.

2. An analysis on the MOFCOM's primary concerns regarding transactions involving multi-steps arrangement

Apart from Meinian Onehealth/Ciming Checkup, OCI/Tokuyama Malaysia⁷ and Canon/Toshiba Medical⁸ are also two typical transactions involving multi-steps arrangement that were challenged by the MOFCOM for gun-jumping:

In OCI/Tokuyama Malaysia, although relevant parties signed three stock purchase agreements regarding specific three steps of a 100% stock acquisition arrangement on one single day, the MOFCOM viewed that the 100% stock acquisition arrangement was a **“one package deal” that aimed to be implemented step by step, these steps were interrelated and shared the same ultimate purpose, and ultimately OCI would be able to obtain power of control of Tokuyama Malaysia, therefore, constituted one concentration.** Since OCI failed to file concentration to the MOFCOM before implementing step ① (the 16.5% stocks transfer), the MOFCOM fined OCI for gun-jumping;

In Canon/Toshiba Medical, the MOFCOM believed that **although the parties had a two-step arrangement, these two steps were strongly interrelated, and were inseparable components for Canon's acquisition of Toshiba Medical's 100% stock, therefore, constitute one concentration.** Since Canon failed to file concentration to the MOFCOM before implementing step ①, and having in mind that this two-step scheme was set up in order to allow Toshiba to obtain total price and get through its financial crisis, Canon knew perfectly well about its merger filing duty while deliberately postpone the filing. The MOFCOM fined Canon for gun-jumping.

Meanwhile, Dade Holding/Jilin Sichang⁹ in 2016 and Fujian Elec/Zhongnuo Telecom¹⁰ in 2015 were also transactions involving multi-steps arrangement, while the MOFCOM handled differently compared with the above three cases:

In Dade Holding/Jilin Sichang, Dade Holding planned to purchase 50% stocks of Jilin Sichang through two steps¹¹, step ① 19% stocks transfer was implemented and completed in November 2011, step ② 31% stocks transfer was implemented and completed in January 2015. Although the MOFCOM regarded the 50% stock purchase as one concentration, it only viewed implementation of step ② as jumping the gun, while did not view implementation of step ① as “initiate to implement concentration” and therefore jumped the gun. We understand that compared with the above three cases, **it is noticeable that three years have passed between the two steps in this case, the degree**

⁷ See <http://fdj.mofcom.gov.cn/article/ztxx/201705/20170502568693.shtml>.

⁸ See <http://fdj.mofcom.gov.cn/article/ztxx/201701/20170102495433.shtml>.

⁹ See <http://fdj.mofcom.gov.cn/article/ztxx/201605/20160501311079.shtml>.

¹⁰ See <http://fdj.mofcom.gov.cn/article/ztxx/201509/20150901124887.shtml>.

¹¹ See Sihuan Pharmaceutical's announcement published in Hong Kong Stock Exchange http://www.hkexnews.hk/listedco/listconews/SEHK/2011/0719/LTN20110719012_C.pdf

of interdependency as well as the close connection between the two steps are significantly lower. We tend to view that the MOFCOM might have taken this circumstance into its consideration, and did not regard the implementation of step ① as jumping the gun.

In Fujian Elec/Zhongnuo Telecom, Fujian Elec purchased Zhongnuo Telecom's 35% stocks, half month later, Fujian Elec's subsidiary Furi Elec proposed to acquire 100% stocks of Zhongnuo Telecom. Since after obtaining 35% stocks of Zhongnuo Telecom, Fujian Elec acquired power of control of Zhongnuo Telecom, and was regarded as gun-jumping by the MOFCOM. In fact, according to Furi Elec's announcement, its goal to acquire Zhongnuo Telecom's 100% stock was quite explicit before Fujian Elec's acquisition of Zhongnuo Telecom's 35% stock, and Furi Elec made it clear that "Fujian Elec's involvement was only a transitory arrangement"¹², given this circumstance, why did the MOFCOM not regard these two arrangement as one concentration?

Different from the above four cases, before Fujian Elec's acquisition of Zhongnuo Telecom's 35% stock, it seems that Furi Elec has not signed any agreement regarding its acquisition of Zhongnuo Telecom's 100% stock. In other words, **although the two arrangement were closely related, but technically they are not steps of one transaction since there is no concentration agreement**, therefore, it would be hard to say that these two arrangement constitute one concentration. We tend to view that the MOFCOM might have considered these factors and only regarded Fujian Elec's acquisition of Zhongnuo Telecom's 35% stock without filing merger control in advance as gun-jumping.¹³

Based on the above cases and analysis, for transactions involving multi-steps arrangement, the MOFCOM would pay close attention to whether these steps are closely interrelated, the ultimate goal of the transaction, whether the same undertaking and its affiliates obtain power of control of target undertaking, etc. **We tend to view that for transactions involving multi-steps arrangement, if relevant parties have reached package agreement, framework agreement, or several agreement involving proposed steps of the transaction, and each steps are relatively closely interrelated, the interval between steps is relatively short, these steps share the same ultimate purpose, and finally the same undertaking (and its affiliates) would obtain power of control of the target undertaking, it is more likely that the MOFCOM would consider these steps as one concentration, therefore, filing merger control for the transaction as a whole before implementing the first step will be required.**

II. Relevant provisions regarding similar transactions in EU Competition Law and referential significance

Section 1.5 of *Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings* (2008/C 95/01) by EC in 2008 (hereinafter referred to as "The Notice") contains provisions regarding the merger filing issues for "interrelated transactions".

The Notice implies that several transactions can be treated as a single concentration because

¹² According to Furi Elec's announcement, "in this transaction, Fujian Elec's acquisition of 35% stock of Zhongnuo Telecom was only a transitory arrangement so as to make the whole deal easier, the ultimate goal is Furi Telecom to acquired 100% stock of Zhongnuo Telecom. "

¹³ In China, when considering whether an undertaking obtains control over other undertaking, whether the control is on a non-temporary basis was not required, therefore, in situation similar with Fujian Elec/Zhongnuo Telecom, whether to make one merger filing or several merger filings regarding these arrangements needed to be analyzed depending on the specific circumstances of the transaction.

they are linked *de jure* or *de facto*.¹⁴ The definition of a concentration implies that **“it makes no difference whether control was acquired by one or several legal transactions, provided that the end result constitutes a single concentration.”**¹⁵ **“Two or more transactions may constitute a single concentration if they are unitary in nature.”**¹⁶

In order to determine whether several transactions can be treated as a single concentration, ‘it is necessary, in each individual case, to ascertain whether those transactions are interdependent’, i.e. **whether “one transaction would not have been carried out without the other.”**¹⁷ Especially, several transactions, even if linked by conditioned upon each other, can only be treated as a single concentration, if the control is acquired ultimately by the same undertaking(s).¹⁸ Only in these circumstances two or more transactions can be considered to be unitary in nature and therefore to constitute a single concentration.¹⁹

This is because under the Merger Regulation, **“transactions which stand or fall together according to the economic objectives pursued by the parties should also be analyzed in one procedure. In these circumstances, the change of the market structure is brought about by these transactions together.** On the other hand, if different transactions are not interdependent and if the parties would proceed with one of the transactions if the other ones would not succeed, it seems appropriate to assess the influence of these transactions on market competition individually.”²⁰

Therefore, it appears that the analyzing approaches are remarkably similar between EU and China in terms of anti-monopoly review of interrelated transactions. Back to the kernel of antitrust review, the most important thing is to analyse the influence of concentration to the competition of relevant market. Furthermore, **a single step of a transaction can never fully reflect the influence of a concentration on competition of relevant market, it can merely reflect how the undertaking(s) obtain control of the target undertaking(s) step by step and how the concentration agreements are implemented. Apparently, they are not considerations when analyzing the effect of a concentration on competition of relevant market in anti-monopoly review.** Even if there might be some uncertainties during the implementation of the subsequent steps in some respects, it makes no essential difference from the ones of a one-time transaction (e.g. give up the deal). It cannot be the reason for not filing the concentration or delaying to file concentration for anti-monopoly review.

Moreover, on July 6, 2017, EC sent a Statement of Objections to Canon for its suspected violation of the EU merger procedural rules in its case against a merge between Canon and Toshiba Medical Systems Corporation.²¹ It reflects EC’s enforcement attitude towards transactions involving multi-steps arrangement. EC opined that **Canon could obtain control of Toshiba Medical Systems essentially before both notifying to, and obtaining approval from, the Commission by a so-called “warehousing” two-step transaction, which means that Canon “jumped the gun”.** Although it will not have an impact on the Commission’s decision approving the merger in September 2016²², which will remain effective, Canon may face heavy fines due to the violation of EC procedure rules.

¹⁴ Besides, the Notice also mentioned another transaction involving the same undertakings within two years. It may also be considered as a single concentration. Since this situation is not related to transactions involving multi-steps arrangement as this article discusses, we would not go into details here.

¹⁵ See para 38 of The Notice.

¹⁶ See para 38 of The Notice.

¹⁷ See para 38 of The Notice.

¹⁸ See para 44 of The Notice.

¹⁹ See para 41 of The Notice.

²⁰ See para 40 of The Notice.

²¹ See http://europa.eu/rapid/press-release_IP-17-1924_en.htm

²² See http://ec.europa.eu/competition/mergers/cases/decisions/m8006_241_3.pdf

III. Discussion of relevant merger filing issues regarding transactions involving multi-steps arrangement

1. It is important to have a right understanding of “undertakings participating in concentration” when filing merger control for transactions involving multi-steps arrangement

Whether to consider transactions involving multi-steps arrangement as a single concentration or several concentrations is really important since it would affect the understanding of “undertakings participating in concentration”. There might be significant differences of the concept in two situations. More importantly, the conclusion of this question also has a great influence on analysis of whether the transactions reach the turnover threshold, which undertaking(s)’s information and market share data should be provided, and whether the transaction falls into exceptions for filing merger control and so forth, therefore has affecting the whole merger filing arrangement of the transaction.

For example, A purchases 100% stocks of C held by B, and it is assumed that the two parties agree to divide the transaction into three steps of 40%, 30% and 30%, and the three steps are closely related. If we consider the transaction as a single concentration, the transaction to be filed would be A’s purchase of 100% stocks of C, and the undertaking participating in concentration would be A and C. If the Chinese turnover of C did not reach RMB 400 million in last accounting year, it might be not necessary to file merger control for this transaction. However, if we consider the first step as a single concentration and it is assumed that A would obtain joint control over C with B by acquiring 40% stocks of C, the undertaking participating in concentration would be A and B when filing merger for A’s purchase of 40% stocks of C.²³ If the Chinese turnover of B reached RMB 400 million in last accounting year, it is likely that a merger filing for this transaction would be necessary. Therefore, different understanding of transactions involving multi-steps arrangement may result in different understanding of undertaking participating in concentration, and then a different conclusion of whether a merger filing is necessary and how to file the concentration, etc.

2. It is important to correctly understand the timing to file concentration regarding transactions involving multi-steps arrangement

As is mentioned before, if we analyze the transactions involving multi-steps arrangement from the relationship of the steps and the purpose of the transactions and so on, we could have a better comprehension from the perspective of AML when analyzing the concentration’s effect on relevant market based on the essence of the transactions, and could avoid to be limited to the external arrangements such as the steps of transactions which are designed based on business needs of the parties. Especially, when each step of the transactions might be a single concentration or a transaction might involve several concentrations, going back to the essence of transactions and regarding the transaction as one single concentration, it will help to lighten the burden of undertakings during merger control filing.

Meanwhile, it should be noted that **if a transaction involving multi-steps arrangement is regarded as a single concentration, the timing to file merger control would probably also be moved up before the implementation of the first step.** In such circumstances, the filing party is advised to prepare and

²³ According to Note 2 of Concentration Declaration Form of Anti-monopoly Review, if the existing enterprise was controlled by a single undertaking before the transactions, undertaking participating in concentration should be all the undertakings that acquire control over the undertaking or are able to exert a decisive influence on the undertaking after the transactions. If business operator who had single control before the transactions acquires control over the undertaking or is able to exert a decisive influence on the undertaking after the transactions, the existing enterprise is not an undertaking participating in concentration.

file for anti-monopoly review at the earliest possible after the overall framework of the transactions is basically determined, and wait for MOFCOM's approval before implementing the first step. If there are indeed some uncertainties in the upcoming steps of the transactions, the parties may also consider to apply for a consultation with the MOFCOM at the earliest possible so as to obtain some guidance or instructions from the authority.

Epilogue

From recent gun-jumping cases that were challenged by the MOFCOM, it is noteworthy that the MOFCOM holds a relatively strict standard when evaluating the timing to file merger control for transactions involving multi-steps arrangement: it will closely analyze the ultimate purpose of the transaction, relationship among these steps, the whole arrangement of the transaction, and tends to view the transaction involving multi-steps arrangement as one single concentration, therefore requiring filing party to file concentration for the transaction as a whole before implementing the first step. Under this circumstance, relevant parties of the transaction are suggested to plan, prepare and submit the filing documents at the earliest possible, if there are indeed some uncertainties regarding the implementation of later step(s), a significant interval between steps, or steps are not closely interrelated, we believe that undertakings may consider to apply for consultation with the MOFCOM after the preliminary framework of the transaction is determined, so as to ascertain the timing to file concentration, reducing the anti-monopoly risk and make sure the transaction can be implemented smoothly.