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MOFCOM rules that foreign-to-foreign deal 'jumped the gun' in breach of antitrust rules

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In a decision adopted on 16 December 2016 and made public on 4 January 2017, the Chinese Ministry of Commerce ("**MOFCOM**") fined Japanese company Canon for failure to file its acquisition of Toshiba Medical Systems ("**Toshiba Medical**") for merger control clearance under the Anti-Monopoly Law ("**AML**"). This decision sends an important message to the business community, demonstrating MOFCOM's willingness to address and enforce against breaches of the AML's merger control rules even more actively and assertively than before.

Transaction structure

In March 2016, Canon agreed to buy 100% of the shares in Toshiba Medical from Toshiba ("**Transaction**"). In anticipation of the Transaction, Toshiba created three types of equity-related rights in relation to Toshiba Medical: 20 shares with voting rights; one share without voting rights; and 100 warrants, allowing the owner to convert them into ordinary shares. In addition, a special purpose vehicle ("**SPV**") was established by three unidentified natural persons days before the Transaction.

The Transaction itself was split into two steps. First, the SPV would acquire the voting shares, while Canon would acquire the non-voting share and the warrants. This first step of the Transaction was completed immediately upon signing of the two sale and purchase agreements between Toshiba with the SPV and with Canon, respectively.

Second, Canon would exercise the warrants (involving payment of a nominal fee of JPY 100, amounting to less than USD 1) and would convert them into ordinary shares, while Toshiba would buy back and cancel the 20 shares with voting rights from the SPV and the non-voting share from Canon. Only the second step of the Transaction was made subject to antitrust approvals: indeed, Canon filed the Transaction with MOFCOM after completing the first step.

MOFCOM decision

In its decision, MOFCOM held that the two steps were indivisible parts of a single transaction. It pointed out in its ruling that the transfer of all shares and warrants – and the "entire" payment – had already been made before notification to MOFCOM.

Unfortunately, the MOFCOM decision does not provide additional details as to the regulator's thinking in terms of how it arrived at the decision. For example, it is not clear from the decision that the natural persons setting up the SPV were affiliated with Canon. Similarly, the decision does not provide guidance on whether the mere fact of acquisition of warrants or other share options – rather than their exercise – would be deemed a notifiable transaction under the AML. In that sense, this is a missed opportunity, as MOFCOM has so far only given indications in this regard through informal means.

In contrast, the MOFCOM decision did reveal that the regulator's assessment was that the Transaction did not raise competition issues.

Following its assessment, MOFCOM decided to impose a fine of RMB 300,000 (around USD 43,000) on Canon.

Impact

The *Canon/Toshiba Medical Systems* decision is MOFCOM's ninth public failure-to-file decision since its announcement in March 2014 to make public all breaches of merger control rules as of 1 May 2014. What is particularly notable here, however, is that this is the regulator's first failure-to-file decision in relation to a purely foreign-to-foreign transaction (as all companies involved in this case are headquartered in Japan). This demonstrates the regulator's willingness to address perceived breaches of merger control rules assertively, even when the companies involved are headquartered outside China.

Equally importantly, the *Canon/Toshiba Medical Systems* decision sends a strong signal to market participants that resorting to artificial transaction structures in order to avoid or delay antitrust filing obligations may not achieve the intended purpose. The decision comes hard on the heels of two cases in 2015 – *Fujian Electronics and Information Group/Chino-E Communications*, and *Fosun Pharmaceutical Development/Suzhou Erye Pharmaceuticals* – where MOFCOM had sanctioned the splitting up of two share acquisitions into two tranches (each a 35% share acquisition as the first step, followed by another package of shares as the second step).

In short, the *Canon/Toshiba Medical Systems* decision shows that MOFCOM may be taking a more assertive stance against certain perceived forms of "gun jumping" going forward.

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