

## MOFCOM Issues Its Eighth Conditional Clearance—Minority Shareholders Beware

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Before granting its approval of Alpha V's acquisition of Savio, China's Ministry of Commerce (MOFCOM) required the private equity fund to divest its 27.9 per cent stake in Savio's rival Uster. With this decision, MOFCOM has signalled its willingness to closely scrutinize the influence of minority shareholders when conducting merger reviews under China's Anti-Monopoly Law.

On 31 October 2011, China's Ministry of Commerce (MOFCOM) announced conditional approval for the acquisition by Alpha Private Equity Fund V, through its subsidiary Penelope Company Limited, of Savio Macchine Tessili S.P.A. This is the eighth decision in three years in which MOFCOM applied conditions before giving approval for an acquisition in China. MOFCOM required Alpha V to sell its 27.9 per cent interest in Uster Technologies Co., Ltd., a company that has a duopoly with Savio in the market for electronic yarn clearers. Savio, through its wholly owned subsidiary Loepfe Brothers Ltd, has a market share—both globally and within China—for electronic yarn clearers of about 52 per cent, while Uster holds the remaining 48 per cent market share. The requirement to sell its shares in Uster is aimed at reducing the risk that Alpha V's control of Savio, together with its significant equity interest in its only competitor Uster, would lead to a restriction of competition.

### Length of Review Process

The period between the acceptance of the initial filing regarding the acquisition of Savio and MOFCOM's acceptance of the completed filing was approximately seven weeks. This relatively lengthy duration has typically been the case with merger reviews under China's competition regime. As such, the Savio decision provides a clear example that, along with the time needed to prepare and submit the initial filing (which usually requires a series of consultations with MOFCOM), businesses should be mindful to allot sufficient time for this additional period in respect of multi-jurisdictional filings that require merger clearance. MOFCOM's increasingly long delays must be built into any closing and financing arrangements.

## MOFCOM Analysis

With regard to the substance of the case, following extensive consultations with third parties, MOFCOM indicated that it had concerns the proposed transaction may have the effect of eliminating or restricting competition in the relevant market (*i.e.*, the market for electronic yarn clearers).

In reaching its conclusion, MOFCOM examined if Alpha V, as a 27.9 per cent stakeholder in Uster, could influence the business operations of Uster. The decision statement indicates that various aspects of Uster were analyzed, including: its shareholding structure, the voting mechanism of its general shareholders' meeting, attendance records of its general shareholders' meetings, and the composition and voting mechanism of its board of directors. MOFCOM determined that the possibility could not be excluded that Alpha V could influence Uster's business operations. As such, the proposed transaction (with Alpha V owning Savio/Loepfe while continuing to have a 27.9 per cent equity interest in Uster) would likely unduly exclude and/or restrict competition in the relevant market.

MOFCOM also indicated that there were significant barriers for new entrants into the relevant market. Two barriers in particular were singled out. In its decision statement MOFCOM noted that: key technologies for electronic yarn clearers are already well protected through the various intellectual property rights of established market participants; and it is generally difficult for a new entrant to quickly develop the economies of scale essential to making a successful entry into any sector of the textile machinery manufacturing industry (*e.g.*, the market for electronic yarn clearers). In sum, with the likelihood of a new entrant coming into the relevant market low—if not altogether impossible—MOFCOM made clear that coordination between Uster and Loepfe arising from the proposed transaction would not be impeded by a new entrant into the relevant market.

In order to ameliorate MOFCOM's anti-competitive concerns, the transaction parties proposed (and MOFCOM ultimately accepted) that Alpha V must:

- Dispose of any Uster shares by transferring such equity interests to one or more independent third parties within six months
- Notify MOFCOM of the identity of any transferees, the transaction volume(s) and the estimated closing date of any transaction
- Not unduly influence Uster's business operations prior to the completion of the divestiture
- Appoint an independent trustee to supervise the divestiture

### Minority Shareholder Control & Notification

The Savio case is perhaps most notable for illustrating how MOFCOM addresses the potential influence of a minority shareholder. Although currently there is no formal guidance as to how MOFCOM will make such a determination, the Savio case seems to indicate that its analysis would be largely in line with the wording regarding the definition of control in the draft version—subsequently omitted in the final version—of the Measures for the Notification of the Concentration of Business Operators issued for public comment in January 2009. The draft defined “control” with respect to a minority shareholder as having decision-making power regarding any of the following: the appointment of one or more board members or key managers, financial budgets, sales, pricing or significant investments; or other important managerial and/or operational matters.

Whatever the precise formula that MOFCOM will use going forward—MOFCOM is likely to issue clarification on the definition of control at some point in 2012—the Savio case certainly puts private equity funds on notice that MOFCOM may deem their purchase or sale of holdings in companies that operate in a particular industry sector as concentrations subject to notification.

### Other Comments

Given that all parties concerned are foreign entities, it will be interesting to see how MOFCOM will effectively supervise whether Alpha V is exercising undue influence over Uster’s business operations prior to divestiture, and Alpha V’s implementation of the plan to transfer its shares in Uster.

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