

## MOFCOM's conditional approval of Marubeni/Gavilon and implications for mergers in the agricultural sector

On 22 April 2013, the Ministry of Commerce of the People's Republic of China (MOFCOM) gave conditional approval to the acquisition of 100% of Gavilon Holdings, LLC by Marubeni Corporation. As with the recent conditional clearance of the Glencore/Xstrata merger, MOFCOM has imposed remedies aimed at reducing possible adverse effects of the transaction in the relevant Chinese market following a lengthy review process.

### Introduction

The increased level of detail in MOFCOM's recent conditional clearance decisions such as the Marubeni/Gavilon decision and also the recent Glencore/Xstrata decision<sup>1</sup> and its consultation process on new draft merger regulations<sup>2</sup> provide useful guidance for companies as to MOFCOM's possible approach in similar mergers. In particular, MOFCOM's decision in Marubeni/Gavilon is instructive as to how MOFCOM may assess future mergers in the important agricultural sector. Similar to its conditional approval of the Uralkali/Silvinit merger involving potassium chloride (an important raw material used in fertilizers), the Marubeni/Gavilon decision also highlights the significance attached to security and continuity of supply in the review of transactions related to sensitive sectors in China.<sup>3</sup>

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<sup>1</sup> See our Briefing, [Implications of China's conditional competition approval of Glencore/Xstrata](#).

<sup>2</sup> See our Briefing, [MOFCOM seeks to streamline and clarify the Chinese merger control process – draft regulations published](#).

### Background

Marubeni is a diversified trading company based in Japan, which engages in the global trading of various products. It has 24 subsidiaries in China and MOFCOM noted it has a well-developed and established distribution network within China. In 2011 and 2012, Marubeni was the largest importer in China's bulk agricultural market. Gavilon is a United States-based private company headquartered in Nebraska, with one subsidiary based in China.

On 29 May 2012, Marubeni and Gavilon entered into a Share Purchase Agreement under which Marubeni would acquire all of Gavilon. A few weeks later, on 19 June 2012, Marubeni lodged a merger notification with MOFCOM to acquire Gavilon. After an initial review, MOFCOM required additional information in order to be able to start the review process, which ultimately began on 31 July 2013.

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<sup>3</sup> See our Briefing, [Horizontal mergers in the China context: The Uralkali potash merger and continuity of supply obligations](#)

### Key issues

- The Marubeni/Gavilon decision provides useful insights into how MOFCOM may analyse other global agricultural mergers, which impact on a market in China.
- MOFCOM formed the view that Marubeni's approximate 20% share of the soybean import market, together with its Chinese sales infrastructure, when combined with Gavilon's US soybean sourcing operations, would likely lead to competition being restricted and eliminated in the soybean import market in China.
- MOFCOM imposed hold-separate remedies involving the requirement on Marubeni to establish separate soybean subsidiaries for the Marubeni and Gavilon operations in the United States relating to soybean exports and sales to China. Firewall (ring-fencing) arrangements are also required between those subsidiaries to be monitored by an independent trustee, subject to supervision by MOFCOM.

On 30 August 2012, MOFCOM decided to conduct a further review and concluded that the proposed transaction was likely to have the effect of eliminating and restricting competition in China's soybean market. With consent from the notifying parties, the review period was extended to 27 January 2013 and proposed commitments were submitted by the merging parties to address the identified concerns. These commitments were not considered to address MOFCOM's concerns effectively. The merging parties withdrew the notification on 25 January 2013 and resubmitted it on 31 January 2013 to give them additional time to negotiate remedies with MOFCOM. MOFCOM accepted the notification on 5 February 2013, and on 5 March 2013, it decided to conduct a further review of the proposed transaction. Ultimately, on 17 April 2013, MOFCOM accepted Marubeni's commitments.

#### Market definition

MOFCOM determined that taking into consideration matters such as the scope and nature of the business of the notifying parties and demand and supply substitutability, the relevant market was China's import market for soybean, corn, bean pulp and dry and course distillers grains. MOFCOM also considered trade flows, transportation, import tariffs, and consumption in China, as well as the global dynamics of the industry in reaching its decision.

#### Competition analysis

China as the world's largest soybean importer consumes 60% of the total global soybean trade and this provides for 80% of domestic supply within China. MOFCOM noted that Marubeni exports 99% of its

soybeans to China, and that Gavilon is similarly active with considerable abilities in terms of purchasing, warehousing and logistics with respect to soybeans in North America. MOFCOM found that:

*"This concentration of undertakings will enable Marubeni to combine its competitive advantages in China's soybean import market with Gavilon's perceived advantages in North America's soybean market. This will enhance Marubeni's ability to import soybeans into China and is likely to strengthen its control over China's soybean import market. Therefore, this concentration has the effect of eliminating and restricting competition in the market."*

In 2012, China imported 58.38 million tonnes of soybeans. As one of the main soybean exporters to China, Marubeni exported 10.5 million tonnes of soybean, an amount MOFCOM found to be greater than competitors ADM, Cargill, Louis Dreyfus, Bunge and other competitors. MOFCOM also found that Marubeni had a competitive advantage in its distribution and client base in China's soybean markets. In 2012, Gavilon sold 5.1 million tonnes of soybean in the global markets. However, it is unclear from the MOFCOM decision how much soybean Gavilon sold in China.

Having regard to these factors, MOFCOM found that given Marubeni's position in China in the relevant market, combining Gavilon's soybean procurement, warehousing and logistics capability would allow Marubeni to further strengthen its "control" of the soybean import market in China – a market characterized by high barriers to entry and weak countervailing

buyer power. Importantly, MOFCOM found that:

*"In order to enter the soybean trade market, reliable soybean supply sources and a sales network are required. Economies of scale are also important for the purposes of competing effectively in this market. Therefore, market entry barriers are relatively high. In the last five years, there has been no major new entrant in the global soybean trade market, or China's soybean import market. This concentration of undertakings will substantially increase the soybean resources under Marubeni's control globally, and in turn the difficulty for potential competitors to enter the relevant market. As a result, it is not likely that the effect of eliminating and restricting market competition raised by this concentration can be mitigated by new market entry."*

*At present, China is highly dependent on soybean imports. The level of concentration among existing Chinese soybean crushers is low. Most of the Chinese soybean crushers have a relatively small production scale, and low bargaining power. It is likely that this concentration of undertakings will further weaken the bargaining power of Chinese downstream soybean crushers."*

In relation to corn, bean pulp and dry and course distillers grains, the combined shares of Marubeni and Gavilon were 6%, 4.5% and 8.4% respectively, and accordingly MOFCOM found that the merger in respect of those products was unlikely to have the effect of eliminating and restricting competition in the relevant import market in China.

## Remedies imposed

MOFCOM ultimately granted conditional approval on the basis that the parties will:

1. Maintain independent operations in relation to the export and sale of soybeans in China, including by undertaking the following:
  - (i) Within six months of completion, establishing two separate legal entities and two independent operating teams to export and sell soybeans to China, with implementation plans to be reported to a supervising trustee as approved by MOFCOM prior to implementation;
  - (ii) The two legal entities are to maintain independent operations, including in relation to human resources, procurement, marketing, sales and pricing;
  - (iii) The Marubeni soybean subsidiary is not to purchase soybean from the Gavilon soybean subsidiary except under fair market terms with the establishment of a firewall between them;
  - (iv) There must be no exchange of competitive information between the Marubeni soybean subsidiary and Gavilon soybean subsidiary and a firewall is to be established.
2. Marubeni, in accordance with MOFCOM's interim Rules on Implementing the Distribution of Assets or Business in Concentrations between undertakings, must appoint an independent supervising trustee.

MOFCOM noted that Marubeni may apply to MOFCOM after 24 months to request release from its obligations under paragraph 1 above.

## Comments

MOFCOM's decision in Marubeni/Gavilon is interesting as to its focus not on requiring continued supply on existing terms as occurred in Glencore/Xstrata, but the establishment of a ring-fenced operation of the merging entities in the United States. The remedies focused on retaining the post-merger independence of Gavilon's soybean operations so as to seek to maintain competitive supply tension for soybean exports to China. It may well be that this ring-fencing arrangement was acceptable to MOFCOM because the actual level of competition between Marubeni and Gavilon in China was limited – and did not require divestment – so that the remedies were able to be focused on preventing the aggregation of Gavilon's sourcing operations in the United States with those of Marubeni in relation to exports to China.

This is not the first time that MOFCOM has imposed hold-separate obligations, alongside information firewall provisions. In Seagate/Samsung and Western Digital/HGST, MOFCOM similarly imposed hold-separate remedies – arguably more far-reaching in Western Digital/HGST – together with a review clause of 18 months (Seagate/Samsung) and 24 months (Western Digital/HGST), respectively. It remains unclear when MOFCOM will require hold-separate remedies and/or information fire-walls. The limited instances to date involved sensitive sectors in China, characterized by a high

degree of dependence on foreign companies/imports.

Further, it is interesting to note MOFCOM's acceptance of combined market shares in other agricultural import markets of up to 8.4% when compared to the market share level, which MOFCOM felt led to an unacceptable restriction or elimination of competition in view of the broader dynamics of the market. That trigger point seems to have been Marubeni's share of soybean imports of approximately 20% (10.5 million tonnes out of 58.38 million tonnes in 2012), together with its established distribution and customer base in China, when aggregated with the potential additional United States soybean sourcing of Gavilon, which sold 5.1 million tonnes of soybeans on global markets in 2012 – an important stake in North America's increasing exports to China.

MOFCOM cleared the Marubeni/Gavilon transaction following a lengthy review. Like its other recent decisions, this case highlights the importance of engaging early with MOFCOM in order to ensure timely clearance – especially where remedies may be required.

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